

PANORAMIC

**PRIVATE EQUITY
(TRANSACTIONS)**

Germany



LEXOLOGY

Private Equity (Transactions)

Contributing Editor

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TRANSACTION FORMALITIES, RULES AND PRACTICAL CONSIDERATIONS

Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Predominantly, private equity investors aim to acquire majority stakes in German companies. However, given the lack of suitable target companies and target companies seeking fresh money or equity, private equity investors are considering acquiring minority interests as well.

Leveraged buyout transactions dominate the private equity market in Germany. But given the current market and the increased reluctance by banks, we have seen an increasing number of transactions in which private equity acquirers fully fund their investments with equity and try to get debt financing at a second stage. The relatively high interest on loans and the decline in profits of the target companies catalyse such development. We have also experienced add-on transactions of portfolio companies held by private equity investors as a consequence of buy-and-build strategies and the requirement for follow-up financing in existing portfolio companies remain at a high level.

In most transactions, a private equity acquirer is willing to grant the management an equity portion in order to align interests with the management team. This management equity portion is in general, again, leveraged in comparison with the interest of the private equity acquirer.

Beside the acquisition of equity portions, we have also seen investment in other instruments such as profit participation rights or silent partnership interests. The private equity acquirer's willingness to enter into such investments depends on the particular case and strategy.

Law stated - 31 Dezember 2024

Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Private equity investors in Germany typically acquire private companies in leveraged buyout transactions that are organised as either limited liability companies, stock corporations or limited partnerships. The law provides for a framework of governance rules for each form of organisation, including, for instance, inalienable shareholder rights, necessary bodies or organs of the company, capital maintenance rules and requirements for insolvency filing.

The corporate governance rules imposed by statute are stricter for stock corporations and much more flexible for limited liability companies and limited partnerships. The strictest and most limiting corporate governance rules apply to listed companies, which have to be organised as a stock corporation (AG), a Societas Europaea (SE) or a limited partnership of shares (KGaA): for example, listed companies are required to comply with

the codified corporate governance rules set out in the German Corporate Governance Code, last amended in April 2022, and with reporting and disclosure requirements on sensitive information that private equity investors typically do not want to share publicly. The governmental commission presented the latest amendment to the German Corporate Governance Code in April 2022, which was adopted and published in June 2022. Inter alia, ESG criteria (environmental, social and governance) have been implemented in the German Corporate Governance Code as a guideline for the management board and supervisory board activities. Legally required gender participation on the management board has to be complied with and a minimum participation of women on the management board has to be observed.

As a result, private equity sponsors typically aim for acquiring or transforming the target company into a limited liability company in order to preserve maximum flexibility. In a limited liability company more specific corporate governance rules are usually set out and agreed in the corporate documents (ie, articles of association, shareholder agreement, rules of procedure for management, etc) of the target company. These further rules aim to increase control over management and limit its power. The rules that are imposed on management in addition to statutory requirements are mostly driven by the responsibilities of the private equity sponsors to supervise and control the management of the target companies in accordance with their internal portfolio guidelines.

Typically, private equity sponsors will only accept the stricter governance rules that apply to the target company after its transformation into an AG for an exit through an initial public offering.

Law stated - 31 Dezember 2024

Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or other private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

The issues the board of directors of public companies face when considering entering into a transaction depend on the role of the public company within the transaction:

- If the listed company acts as a seller the board of directors represents the company in the negotiations and preparation of the transaction and also in the conclusion of the agreements to implement the transaction. If the transaction or the preparation of a transaction is to be considered as insider information for the (selling) listed company, the board of directors has to make an ad hoc announcement in order to inform the market of the intended sale of the target. Under certain prerequisites management may decide on a deferral of such ad hoc announcement to avoid disadvantages in the selling process. However, such a decision on the deferral needs to be documented in minutes and supported by the board. Decisions on allowing potential buyers to undertake due diligence on the target have to be carefully

considered and the information presented in the due diligence has to be thoroughly selected. Management has to ensure that no insider information is being passed on to the potential buyers of the target in the due diligence process. The board of directors must also consider that allowing a due diligence already requires approval by the supervisory board according to the corporate governance guidelines, which is typically the case. To avoid personal liability and to enable the supervisory board to perform proper control over management (but not for the legal effectiveness of the transaction) the board of directors typically requires an approving resolution of the supervisory board before signing the deal. In rare cases, however, where the listed company sells its major assets in the transaction, a shareholder resolution needs to be obtained in order for the transaction to become legally effective.

- If the listed company is the purchaser of the target the board of directors has to consider at what point in time the preparation or conclusion of the transaction becomes insider information that requires an ad hoc announcement to the market. The board of directors may also make a decision on a deferral. A resolution of the supervisory board is required before the actual signing of the transaction, and not only for legal effectiveness but also to enable proper control of management by the supervisory board.
- If the listed company is the target of an attempted public take-over, the board of directors has to decide on allowing the potential bidder to undertake due diligence. It has to decide if and what information can be provided to a bidder without violating the company's interests and without passing on insider information. This decision can already require approval by the supervisory board, to avoid personal liability for the management. In any case, it is at least advisable that every decision of the board of directors is supported by a resolution of the supervisory board. The board of directors is allowed to take pre-bid defensive measures (eg, by setting up a defensive manual to prepare for defensive measures in case of a hostile take over) as well as certain post-bid defensive measures in accordance with the Securities Acquisition and Takeover Act and the Stock Corporations Act, but the rules are strict and in general, the board of directors is rather limited in taking any defensive measures against a hostile takeover. In any event, the board of directors and the supervisory board have to give a public statement and give comments on the evaluation of the public takeover offer from their perspective.
- Disregarding the role of the company in the transaction if any benefits or considerations are gained by or promised to the board of directors in connection with the transaction, such benefits need to be disclosed and a conflict of interest shall not affect the decision of the board, otherwise, the board could face personal liability.

Law stated - 31 Dezember 2024

Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

If the target company is publicly listed, an investor must notify the target company and the Federal Financial Supervisory Authority (BaFin) once it obtains or surpasses 3, 5, 10, 15, 20,

25, 30, 50 and 75 per cent of the target's voting rights pursuant to the Securities Trading Act. In turn the target company has to publish the voting rights of the investor. The obligation to notify also applies if the voting rights are held indirectly (eg, through financial instruments). Investors reaching 10 per cent of the voting rights in a listed company must inform the target company of their intended objectives and their source of funding within 20 trading days. The investor must further specify its intentions with respect to:

- its strategic goals or returns from investing;
- the acquisition of additional voting stock in the next 12 months;
- exerting influence on the company's management or supervisory board; and
- the substantial modification of the capital structure of the target.

In turn, the target company needs to disclose such information to the public.

If more than 25 per cent or the majority of shares in an unlisted German AG are acquired, the acquired company must be notified. The same applies in the case of a shortfall of these thresholds. In the case of a failure to meet such requirements, the shareholder may not exercise the voting rights from its shares.

When shares in a limited liability company (GmbH) are acquired, a new list of shareholders has to be registered with the competent commercial register, which is publicly available. Any new partner to a partnership needs to be registered with the competent commercial register.

Further filing requirements for acquirers of shares apply pursuant to the Money Laundering Act. All legal entities governed by private law have to file certain data with the Transparency Register, inter alia regarding the beneficial owners in the company (ie, persons directly or indirectly holding more than 25 per cent of the shares or control more than 25 per cent of the voting rights or exercising control in a comparable way (eg, by voting trust or pooling agreements)). Violation of the filing obligation is punishable by a fine.

In mergers and acquisitions transactions in which the management of alternative funds (AIFM) are involved, disclosure requirements pursuant to the Capital Investment Act must be considered. When such AIFM acquires, disposes or holds shares of a non-listed company on behalf of an of alternative investment fund (AIF), the AIFM must notify BaFin of the proportion of voting rights of the non-listed company held by the AIF any time that portion reaches, exceeds or falls below the thresholds of 10, 20, 30, 50 and 75 per cent. When an AIF, individually or jointly, acquires control over a non-listed company or an issuer the AIFM managing such AIF must notify the non-listed company concerned, the shareholders of the company and the competent authorities of the home member state of the AIFM, and must make available further information with respect to, inter alia, the situation regarding the voting rights at the time of acquiring control, the policy for preventing and managing conflicts of interest and the policy for external and internal communication relating to the company in particular as regards employees, its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment. The company needs to inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the information.

According to the Foreign Trade Act and the relevant ordinance, the Federal Ministry of Economics and Energy (BMWi) needs to be informed if the investor originates from outside the European Union or the European Free Trade Association.

According to the merger control provisions of the German Act against Restraints of Competition, transactions have to be disclosed to the Merger Control Authority if the parties to the transaction meet certain thresholds.

Law stated - 31 Dezember 2024

Timing considerations

What are the timing considerations for negotiating and completing a going-private or other private equity transaction?

Typically, private equity and going-private transactions are advised by investment banks or mergers and acquisitions (M&A) advisers.

The acquisition of private companies is usually organised in auction processes coordinated by the seller's M&A advisers. The duration of such a transaction (including the planning phase and post-closing measures) varies from a few weeks up to several months, depending on the individual circumstances, such as the size of the transaction, transactional and financing structures, time pressure on the buyer's or seller's side and if public approval or clearances (eg, antitrust) are necessary. The timeline for the auction is set out by the M&A advisers organising the process. The auction process begins with sending out teasers to potential buyers and conclusion of a non-disclosure agreement. Interested bidders gain access to an information memorandum containing basic financial and legal information about the target company and are then asked to submit non-binding offers outlining their ideas regarding the purchase price and transaction structure. Certain bidders are then selected and are granted access to a data room to perform due diligence on the target, which, depending on the size of the transaction, takes two to four months. After the due diligence the bidders are requested to submit binding offers including a mark-up of the sale and purchase agreement provided by the seller. The seller then enters into negotiations with its preferred bidders. While the negotiations between the seller and the bidder take place, the bidder is typically simultaneously negotiating financing and warranty and indemnity (W&I) insurance for the transaction. These side negotiations usually set the minimum time frame for the negotiation between the seller and the bidder as these elements are a prerequisite for signing the transaction. The conclusion of the sale and purchase agreement (the Signing) and the actual transfer of the shares (the Closing) are typically done in two separate steps, as the transfer in rem of the shares in most transactions is subject to the payment of the purchase price and other conditions precedent (eg, merger control clearances and other public approvals). If merger control clearance is required there is a period of at least one month between the Signing and the Closing, as this is the time frame within which the Federal Cartel Authority may review the transaction and declare clearance or denial.

To take a publicly listed company private the acquisition of shares by a private equity investor are typically initiated through a block trade by which – outside the stock exchange – the acquisition of a bigger share package is being negotiated with one or several major shareholders. This is then combined with a public tender or takeover offer to obtain control over the publicly listed company. In any event, if a party obtains control of a public company either through a block trade purchase on the stock exchange or a public tender (ie, acquires at least 30 per cent of its voting rights, as defined by the Takeover Act), a public takeover offer becomes mandatory. This requirement needs to be considered if a private equity investor

acquires or intends to acquire a substantial participation in a publicly listed target. Once the investor obtained control or the intention of the investor to make a public offer has been announced, the process for the takeover offer normally takes about 12 weeks (maximum up to 22 weeks). The duration of possible stakebuilding measures or a due diligence review before control is obtained or an announcement of an offer is made varies widely depending on the individual circumstances. To efficiently take a publicly listed company private (ie, not only cancel the listing with the stock exchange but also have no further minority shareholders in the company), private equity investors in Germany aim to acquire 100 per cent of the shares in the target. However, it is almost impossible to acquire 100 per cent of the shares in the target through a public takeover offer, as not all shareholders will accept the offer. In this case German law provides for procedures to squeeze out the minority shareholders. However, the prerequisites for a squeeze-out of minority shareholders are very strict and formal: the investor needs to hold at least 90 per cent or 95 per cent of the share capital in the target company and must pay or offer adequate cash compensation to the minority shareholders. Depending on the legal grounds for the chosen procedure to squeeze out the minority shareholders, the preparation (in particular the report on the adequacy of the offered cash compensation) and execution of the squeeze-out can take several months. If the minority shareholders dissent or object to the squeeze-out and exhaust their legal remedies to appeal, the timeline for the squeeze-out is significantly extended.

Law stated - 31 Dezember 2024

Dissenting shareholders' rights

What rights do shareholders of a target have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Shareholders of a target are protected against going-private transactions in several ways. First of all, any bidder acquiring, directly or indirectly, 30 per cent or more of a listed (on an organised market) target's voting rights must make a mandatory offer to the remaining shareholders of the target to acquire their shares according to the Takeover Act. In this public takeover offer, the bidder must offer adequate consideration to the remaining shareholders, which can be challenged by the shareholders and reviewed in court. However, this right for each individual shareholder does not prevent the completion of the transaction itself, as it only leads to a review of the compensation. This may be different when a bidder makes an offer under the condition of reaching a certain number of voting rights with the offer. Typically, bidders aim to acquire 75 per cent of the voting rights or 90 or 95 per cent of the share capital, so following the public offer the bidder is able to actually take the company private and initiate substantial corporate measures such as a delisting, statutory mergers, domination and profit and loss transfer agreements or squeeze-out resolution, etc. If the required quota in the public offer is not reached, the transaction fails. However, individual shareholders who do not hold enough shares to jeopardise the threshold will not be able to dissent or object to the transaction. Minority shareholders can only decide to either sell their shares or remain shareholders in the company.

Following a public offer, if a corporate taking-private transaction of the bidder requires a shareholder resolution and registration with the commercial register for its effectiveness (as is the case with, for example, mergers, change of legal form and corporate squeeze-outs),

minority shareholders may try to interfere by taking action against the validity of the resolution (eg, the squeeze-out resolution) by filing a suit to set aside the shareholders' resolution for violating the law or the articles of association. Such litigation is mostly manageable for the company and the bidder by taking advantage of a special release proceeding. The rights of minority shareholders to challenge the validity of a resolution may only hold up the transaction, but will not be able to finally prevent it. However, the possibility of a going-private transaction being held up can affect the decision of bidders to launch an offer in the first place, as time can be essential (eg, for financing). Claims of minority shareholders with the aim of receiving additional compensation usually do not impede the effect of the squeeze-out itself (except for the takeover-related squeeze-out).

Law stated - 31 Dezember 2024

Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

In general, purchase agreement provisions in private equity transactions are similar to other common purchase agreement provisions for acquiring shares in companies. However, certain specific aspects are commonly included, which are regularly included in purchase agreements when private equity acquirers are involved.

For instance, private equity investors typically avoid providing extensive operational representations and warranties. Therefore, private equity sellers regularly demand the purchaser to take out warranty and indemnity insurance to limit possible liability under the sale and purchase agreement. In rare cases, the management of the target company agrees on a separate warranties' agreement with the buyer, given their deeper insight into the company's operations.

On the buy-side, private equity acquirers increasingly request warranties related to environmental, data protection, social, compliance and governance (ESG) standards, sometimes explicitly referencing the United Nations Principles for Responsible Investment.

Regarding deal certainty, sellers generally seek firm financing commitments from private equity buyers, as fund structures can sometimes present tax-related complexities. As a result, private equity funds typically provide an equity commitment letter in favour of their special purpose vehicle, which serves as the acquisition entity. From the seller's perspective, the equity commitment should fully cover the required funds for the purchase price, including transaction costs and potential refinancing of the target. Additionally, provisions for potential damages should be considered in case the transaction does not close due to reasons attributable to the other party. If notarisation is required – such as, for the sale of shares in a limited liability company – the equity commitment letter may also need to be notarised alongside the purchase agreement.

Law stated - 31 Dezember 2024

Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity acquirer should discuss management participation following the completion of a going-private transaction?

In general, there are no differences between going-private transactions and other private equity transactions regarding future management participation. Nevertheless, there might be specific issues with regard to compensation or management participation arising from specific regulatory provisions applicable to listed target. These provisions no longer apply after the delisting of the target.

The existing service agreements of the management team members are usually renewed. A private equity acquirer normally offers to increase compensation, as well as to set a fixed time period for the service agreement of up to five years.

Beside the service agreements of the management team members, which usually include bonus provisions in connection with operational and financial targets, a private equity acquirer intends to incentivise the management team on a successful exit. This is usually done by offering either an equity participation or an exit bonus. A manager's equity stake is mostly legally held by a pooling vehicle in the legal form of a limited partnership or by a trust company via a trusteeship. In smaller deals the managers occasionally hold their shares directly (or indirectly via an investment vehicle). In any event, equity participations are structured in order to minimise the risk of the tax authorities arguing that profits from the equity participation are treated as employment income and, therefore, a higher tax rate applies. On the other hand, an exit bonus is treated as employment income. When structuring a management participation, it should be avoided to trigger an initial taxation upon acquisition of the participation, as the manager has not yet received any funds to pay such taxes (dry income). Any taxes should therefore only be incurred once the manager has received the necessary funds to pay the tax. In private equity transactions, this is regularly the case at the time of an exit. The risk of initial taxation arises in particular, if the management acquires the participation at a discount. However, the legislator has attempted to promote employee share ownerships in start-up companies, micro-enterprises and small and medium-sized enterprises by ensuring that wage tax shall not be triggered at the time of the transfer of the shareholding, but rather at a later date, usually with the sale of the shareholding, but at the latest after 12 years (from 2024: 15 years) or in the case of a change of employer.

Generally, a private equity acquirer should contact the management of the target company as early as possible in order to be able to agree with the management on a term sheet or even a shareholders' agreement until the signing of the share purchase agreement has taken place. Early discussions on management's participation also offer the possibility to convince the management team of the private equity fund. This can be a relevant advantage in an auction process.

Law stated - 31 Dezember 2024

Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The fundamental tax considerations for private equity acquirers in Germany remain largely unchanged, though recent legislative developments have introduced some modifications. On the one hand, private equity acquirers focus on the ability to utilise the expenses and losses of the acquisition vehicle, such as interest costs. On the other hand, they seek tax-efficient structures to transfer the profits of the target company to the acquisition vehicle. This can still be achieved, subject to certain limitations, by forming a fiscal unity between the acquisition vehicle and the target company. If certain conditions are met – such as the execution of a profit transfer agreement – the taxable income of the target company is attributed to the holding company.

With respect to interest deductibility, which is particularly relevant in leveraged buyout transactions, German law continues to limit the deductibility of interest expenses to 30 per cent of earnings before interest, taxes, depreciation and amortisation. However, as part of the implementation of the EU Anti-Tax Avoidance Directive, the previous group-related exemptions, including the stand-alone clause and the so-called equity escape, have been modified or abolished, restricting the possibilities for interest deductions in some cases. The definition of interest has also been adjusted. The limitation does not apply if the interest expenses are below €3 million or if the company is not part of a consolidated group.

Additionally, loss carryforwards remain restricted under German tax law. In particular, if more than 50 per cent of a company's shares are directly or indirectly acquired within a five-year period – a scenario typical for private equity transactions – existing tax losses are generally forfeited.

Furthermore, if the target company owns real estate, the direct or indirect acquisition of at least 90 per cent of the company's shares triggers real estate transfer tax, ranging between 3.5 per cent and 6.5 per cent, depending on the federal state. The tax is calculated based on the fair market value of the real estate held by the company.

Law stated - 31 Dezember 2024

DEBT FINANCING

Debt financing structures

What types of debt financing are typically used to fund going-private or other private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Senior loans provided by traditional banks are the most common way of financing private equity transactions. As traditional banks become more reluctant to leverage financing in the current market, a growing amount of senior loan financing is provided by alternative financing providers, such as debt funds, which have higher interest margins and usually request the

opportunity to also invest through additional mezzanine or equity financing instruments to achieve higher margins. In larger transactions, high-yield bonds can be seen, but this form of financing is commonly used by strategic investors.

Existing indebtedness of the target company is usually fully exchanged and refinanced in the acquisition, as lenders to the acquiring company aim to obtain full access to existing securities and the cash flow of the (operative) target company. However, upstream guarantees and securities by subsidiaries (target companies) issued to their parent company (acquiring company) interfere with German capital maintenance rules. Therefore, it takes some effort to structure a debt-push-down, which is typically achieved through a profit and loss agreement or a merger between the target and the acquiring company.

Law stated - 31 Dezember 2024

Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements for private equity transactions? What other documents typically set out the financing arrangements?

To take a publicly listed company private, a public takeover offer has to be initiated. The bidder is required to transmit an offer document to the Federal Financial Supervisory Authority (BaFin) and to publish the offer. For the public offer, an independent financial services institution (eg, an investment bank) needs to provide a financing letter confirming the availability of sufficient funds to pay for the offer (ie, the bidder needs to have sufficient financing to purchase all outstanding shares in the target company). As the financial services institution may be held liable if the bidder is unable to pay for the respective shares, the bidder needs to have and prove enough debt and equity financing for the financial services institution to submit such a confirmation letter.

Law stated - 31 Dezember 2024

Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving debt financing raise 'fraudulent conveyance' or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

There is no legal institution in the German legal system comparable to the fraudulent conveyance law known, for example, in the United States. In Germany, the protection of creditors is ensured mainly by capital maintenance rules, the insolvency contesting rules and the obligation to file for insolvency if the company becomes over-indebted or illiquid. In addition, there are also accompanying legal institutions developed in case law, such as the prohibition for shareholders to take existence-destroying interventions. The provisions of German corporate law, however, are not sufficient to protect the creditors properly against the risks resulting from excessive debt financing: the capital maintenance rules are, for example, only addressed to shareholders. The financing banks are not addressed by the relevant prohibitions (at least as long the company is not distressed). Moreover, the creditors

of limited liability companies are, under the Limited Liability Companies Act, only protected against the occurrence of a loss in share capital, but not against other actions that may disadvantage creditors.

More comprehensive creditor protection is provided by the insolvency contesting rules intended to reverse transactions that harm all creditors, or that favour individual creditors to the detriment of the others. In contrast to fraudulent conveyance, a disadvantageous legal act prior to the opening of insolvency proceedings alone is not sufficient under the Insolvency Act to substantiate a contest. The Insolvency Act contains various contestation reasons that have to be fulfilled additionally. Of particular importance is the possibility to contest a transaction owing to wilful disadvantage. On this basis, particularly high-risk transactions or transaction structures that are likely to cause insolvency of the company can be reversed by a liquidator.

Law stated - 31 Dezember 2024

SHAREHOLDERS' AGREEMENTS

Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms or other equity co-investors? Are there any statutory or other legal protections for minority shareholders?

With regard to the protection of minority shareholders, German corporate law provides information, monitoring and examination rights, as well as the right to request a shareholders' meeting, depending on the legal form of the company. In addition, under German law, a change in the company's purpose requires the mutual consent of all shareholders unless otherwise explicitly stipulated in the articles of association. Other substantial amendments to the articles require qualified majorities. For example, capital increases require the consent of a qualified majority of 75 per cent of shareholders' votes in a limited liability company and at least 75 per cent of the share capital in a stock corporation (AG). The articles of association of an AG may generally stipulate a higher or lower capital majority, subject to certain exceptions. However, the requirement for a capital majority cannot be waived. A simple capital majority – meaning the approval of more than 50 per cent of the share capital represented at the time of the resolution – is mandatory. A majority of votes alone is not sufficient.

Beyond statutory protections, private equity investors as minority shareholders negotiate customised rights through shareholders' agreements, particularly when investing alongside co-investors or other stakeholders. These agreements typically include:

- veto rights on key decisions, such as capital expenditures, acquisitions, divestitures, and debt financing;
- enhanced information and reporting rights, ensuring access to financial statements, management reports, and strategic planning documents beyond statutory requirements;
- non-compete and non-solicitation provisions to protect the investor's interests against dilution of value; and

- transfer restrictions and rights, including rights of first refusal, drag-along rights, tag-along rights, and, where applicable, call and put options to facilitate controlled liquidity events.

In 2024, liquidity considerations and exit strategies have become increasingly critical in structuring minority investments. Private equity investors prioritise flexibility in exit mechanisms, ensuring they can exit at their own discretion – often by triggering a joint exit for all shareholders and maintaining control over the exit process. Given recent market shifts, investors are placing greater emphasis on structured exit rights, including pre-agreed IPO timelines, secondary sales to institutional investors, and hybrid exit models that combine private sales with staged public offerings.

Law stated - 31 Dezember 2024

ACQUISITION AND EXIT

Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Besides antitrust regulations and the reporting obligations and review procedures contained in the Foreign Trade Act, there are certain limitations and obligations for private equity firms in larger transactions that fall under alternative investment fund regulations after acquiring control of a non-listed company. For a period of 24 months following the acquisition the private equity purchaser is prevented from stripping any assets from the target company that may have an impact on the ability to finance the transaction.

In the case of publicly listed companies, the Takeover Act has an effect: if a private equity firm gains control of a public company (ie, acquires at least 30 per cent of its voting rights), it is, obliged to submit a mandatory public offer to the remaining shareholders of the target to acquire their shares pursuant to the Takeover Act. In certain cases, the voting rights from shares held by third parties have to be attributed in the calculation of the 30 per cent threshold (eg, voting rights of a subsidiary, bidder and third party are 'acting in concert'). In the event that two or more parties acquire control on the basis of the aforementioned attribution, the obligation to submit a mandatory offer generally applies to all acquirers.

Law stated - 31 Dezember 2024

Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity acquirer?

In 2024, the conditions for private equity firms exiting portfolio companies have changed compared to 2023. Lower interest rates have reduced financing costs, improving market sentiment and making IPOs more attractive. Additionally, the stabilisation of macroeconomic

conditions has strengthened investor confidence, leading to a modest recovery in the IPO market.

However, three key factors still limit private equity firms' ability to exit via an IPO. First, institutional investors must be convinced of the business case and long-term growth potential of the portfolio company. Second, the company must be IPO-ready, meaning its governance structure must meet the compliance and transparency requirements of a public company. In particular, portfolio companies structured as limited liability companies must first be converted into a *Societas Europaea* (SE), a stock corporation, or a limited partnership by shares. Third, market conditions remain crucial, as economic volatility and sector-specific risks continue to impact IPO windows, despite improved financing conditions.

For trade sales, the valuation gap between buyers and sellers remains a key obstacle, as sellers' price expectations do not always align with the cautious approach of buyers. While higher interest rates in 2023 constrained deal-making, the lower rate environment in 2024 has improved buyers' ability to finance transactions. However, uncertainties about business sustainability and earnings projections persist, leading to increased due diligence and selective acquisitions.

In this context, potential liabilities – especially for representations and tax indemnities – are increasingly being shifted to warranty and indemnity insurance. Private equity sellers continue to expect buyers to rely on warranty and indemnity insurance, and escrow mechanisms remain rare in 2024.

Law stated - 31 Dezember 2024

Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

After an IPO, only the statutory governance rights survive. A shareholders' agreement is usually terminated upon the IPO, which constitutes an exit of the private equity investor, although it could remain as a shareholder of the listed company. Under German statutory law, it is to some extent possible, but rather unusual, to agree on rights to appoint board members for single shareholders in the articles of association of the listed company.

Lock-up periods usually have a duration of between six and 12 months for private equity investors, but are sometimes longer when it comes to management. Management advisers regularly try to agree on a provision in the shareholders' agreement that in the case of an IPO, the lock-up period for the management team will not be longer than the lock-up period of the private equity investor. However, the proposal for the duration of the lock-up period is finally at the discretion of the underwriting banks.

Usually, in an IPO, only a small portion of the shares of the existing shareholders are sold. Private equity investors sell packages of shares after the termination of the lock-up period and in predefined time periods.

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Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in industry focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Private equity transactions continue to take place across almost all industries, with a notable rebound in deal activity in 2024. While macroeconomic uncertainties persist, lower interest rates, improved financing conditions, and stabilising inflation have created a more favourable environment for transactions. As a result, private equity funds are increasingly pursuing going-private transactions, leading to a steady number of delistings from public markets.

Carve-out transactions and competitive auction processes remain key drivers of deal flow. Healthcare, technology, software, and digital solutions continue to be attractive target sectors, particularly in the mid- and small-cap segments. Additionally, energy, infrastructure, and sustainability-focused businesses have gained significant interest, with investors capitalising on regulatory incentives and the global push for decarbonisation. Industrial and manufacturing companies that focus on automation, AI-driven efficiencies, and supply chain resilience have also become increasingly appealing for private equity firms looking for long-term value creation.

From a structural perspective, companies with stable cash flows and strong growth potential remain prime candidates for going-private transactions. Lower leverage ratios facilitate debt financing, while a limited free float helps streamline the delisting process. Additionally, founder- or entrepreneur-led businesses continue to seek private equity backing to execute long-term strategic growth initiatives outside the constraints of public markets.

On the regulatory front, scrutiny of private equity investments in critical infrastructure has intensified. The Federal Ministry for Economic Affairs and Climate Action closely monitors transactions involving defence, cybersecurity, energy supply, and other key infrastructure sectors. Regulatory updates in 2024 have led to stricter foreign direct investment controls, increasing transparency requirements and approval thresholds for cross-border private equity transactions in sensitive industries.

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SPECIAL ISSUES

Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or other private equity transaction?

With respect to financing a cross-border transaction, when a cash offer is made in the context of a cross-border going-private transaction, an independent financial services institution (eg, an investment bank) needs to confirm the availability of sufficient funds of the bidder. The financial services institution may be held liable if the bidder is then unable to pay for the respective shares. However, this does not constitute a difference from mandatory public takeovers.

Germany is an open economy; foreign investments are, in general, permissible and welcome. However, foreign investments in target companies active in certain sectors may be reviewed on a case-by-case basis by the Federal Ministry for Economic Affairs and Climate Action (BMWi). The Foreign Trade Act and the relevant ordinance provide for a sector-specific review mechanism, mainly concerning the military and defence as well as critical infrastructure sector, and for a cross-sectoral review concerning acquisitions of companies in other sectors, but only by investors from outside the European Union or the European Free Trade Association, under which the BMWi may prohibit direct or indirect acquisitions of at least 20 or 10 per cent of the voting rights (depending on the sectors) in a German target or impose obligations if it finds that the acquisition endangers public order or security in Germany.

Since July 2017, acquisitions of German targets active in specific areas such as critical infrastructure and development of industry-specific software for the operation of critical infrastructure must be notified to the BMWi. The sectors and areas for which a notification is required have been significantly extended over time. Apart from that, the BMWi acts on application for the issuance of a certificate of non-objection or on its own initiative in the cross-sectoral review. In the sector-specific review, there is a general reporting obligation regarding relevant transactions.

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Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

In club or group deals, the mutual rights and obligations should be determined as early as possible. Typically, the sale of a target company is subject to a formal structured auction process. To align the interests of the acquirers during the auction process, the acquirers should enter into a bidding consortium agreement to govern the obligations and the behaviour of the parties during the process. This agreement typically contains provisions with regard to the later acquisition and operation of the target company, and is substituted by the shareholders agreement, which follows after the closing of the transaction. Internal governance rules must also be defined, such as which quorums must be achieved for which types of decision. Simple or qualified majorities will be sufficient for many decisions. However, individual points require unanimity, which applies in particular to the purchase price of the deal or with regard to closing conditions. Provisions with regard to deadlock situations should especially be provided for. With regard to a leaving club member, regulations on exclusivity, restrictions on competition and confidentiality should be regulated.

With respect to the joint acquisition of at least 30 per cent of the voting rights in public listed companies ('acting in concert'), the Takeover Act may lead to the obligation to submit a mandatory takeover offer to the other shareholders. Bidding consortium agreements must consider the 'acting in concert' rule and ensure that only one takeover offer by the consortium becomes mandatory. Moreover, agreements between bidders in an ongoing auction process must be viewed critically under antitrust law, particularly if such agreements are intended to influence the purchase price. An agreement under which one bidder withdraws from the auction process but in return is to receive a share in the target company from the other (successful) bidder after completion of the transaction may be illegal under antitrust law.

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Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity acquirer related to certainty of closing? How are these issues typically resolved?

In 2024, the DACH (comprised of Germany, Austria and Switzerland) private equity market remains seller-friendly, with closing conditions largely limited to antitrust clearance. Additional conditions are rarely accepted unless deal-specific risks exist. Regulatory scrutiny has intensified, particularly due to foreign subsidies rules, which now require EU Commission approval for transactions involving non-EU financial contributions exceeding €50 million. This creates potential delays in deal execution, similar to antitrust merger control.

Private equity buyers continue to face challenges negotiating material adverse change (MAC) clauses or termination rights, instead having to accept break fees and 'hell-or-high-water' obligations to secure deals. Given high competition and strong seller leverage, private equity acquirers must ensure certainty of funds and a streamlined closing process to remain competitive.

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UPDATE AND TRENDS

Key developments of the past year

Have there been any recent developments or interesting trends relating to private equity transactions in your jurisdiction in the past year?

With effect as of 15 December 2023, the Future Financing Act has been passed with the aim to improve the financial framework for companies and startups, particularly in the tech sector. Its primary goals are to facilitate access to capital markets, simplify regulatory requirements, and encourage investments in innovative technologies. Key measures include tax incentives for investors and employees, reducing bureaucratic hurdles for IPOs, and promoting digital securities.

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