Acquisition Finance 2019

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LEXOLOGY
Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the seventh edition of *Acquisition Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Germany and Sweden.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Financing agreements in relation to acquisitions (i) where the borrower is owned by a private equity sponsor or (ii) which are to be syndicated internationally are typically governed by English law in the case of loans or New York law in the case of bonds. Financing agreements for German corporate borrowers or involving primarily German banks which are being marketed predominantly in Germany to German investors are typically governed by German law. It remains to be seen whether the uncertainties resulting from a potential hard Brexit will result in an increase in German law governing acquisition financing agreements.

German courts generally recognise the choice of foreign law to govern transaction agreements. However, collateral agreements creating liens over, inter alia, the shares in German companies or partnership interests in German partnerships, real estate situated in Germany and receivables arising under agreements governed by German law must be governed by German law.

German courts recognise and enforce judgments obtained in other EU member states on the basis of and within the limits set out in the recast Brussels Regulation ((EU) No. 1215/2012) and, in specific cases, the European Enforcement Order Regulation ((EC) No. 805/2004). Further judgments from courts of Iceland, Norway and Switzerland are recognised on the basis of the Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters. As a member of the EU, Germany is also party to the Hague Convention on Choice of Court Agreements, which gives effect to choice-of-court agreements and recognition of resulting judgments between contracting states (currently the EU member states (except for Denmark), Mexico and Singapore).

In the case of a hard Brexit, the recast Brussels Regulation would no longer apply to the UK, with the result that UK judgments would no longer be recognised and enforced under such Regulation. The fall-back would be the bilateral German–British Convention on the mutual recognition of judgments, which was signed in 1960. However, the scope of this treaty is significantly smaller than the scope of the recast Brussels Regulation. The UK government has indicated that the UK could seek to re-join the Lugano Convention after a hard Brexit. However, at present, there is uncertainty as to whether (and when) this will occur.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

There are only a few restrictions regarding acquisitions of domestic companies by foreign entities, as summarised below.

Under the Foreign Trade and Payments Ordinance (AWV) (as last amended on 19 December 2018), the German Ministry for Economic Affairs and Energy is to be notified and may initiate a review if a foreign entity intends to (directly or indirectly) acquire at least 10 per cent of the voting rights in a German company engaged in certain critical infrastructure sectors (eg, energy, water, food and telecommunications). The same applies to the (direct or indirect) acquisition of German media companies and German companies engaged in certain security-sensitive sectors comprising military products and security-sensitive IT products. In case of a review, the German ministry for Economic Affairs and Energy may prohibit the acquisition or issue an order within three or four months after the receipt of the complete documents. In the event of a cross-sector review, the Federal Government has to agree to the measure. In this respect, we note that, with respect to acquisitions in German arms companies, provisions under the German Foreign Trade Act also apply.

Further, there are certain restrictions and notification obligations applying to both foreign and domestic bidders and purchasers. These apply in practice most commonly where at least 10 per cent of the share capital or voting rights in a German bank, insurance company or other entity subject to financial markets supervision is being acquired.

Acquisitions of listed German companies and certain European Economic Area (EEA) companies listed only on a regulated market of a German stock exchange are subject to the German Securities Acquisition and Takeover Act (WpÜG). In such cases, the WpÜG governs, inter alia, the way that an offer must be made for such a company and whether or not the offeror or purchaser must make a mandatory offer.

The German Capital Investment Act (KAGB) imposes disclosure obligations on managers of certain private equity and other unregistered funds that acquire 10 per cent or more of the voting rights in German non-listed companies (eg, under sections 298, 299 and 290 KAGB, which implement provisions of Directive 2011/61/EU on Alternative Investment Fund Managers). More onerous reporting and asset-stripping obligations apply on funds that acquire 'control' of German non-listed companies and issuers whose securities are admitted to trading on a regulated market of a German stock exchange.

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Types of debt

3 | What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

At the time of the acquisition, the typical debt components comprise senior term loans or senior notes combined with a senior or super senior revolving facility. Second lien and mezzanine financings have become less popular in recent times. This is mainly due to the high liquidity in the senior loan market and the relatively high costs involved with second lien and mezzanine financings.

More specifically, in mid- and large-cap acquisitions by private equity funds, the term loan components are typically either broadly syndicated to banks and institutional lenders (TLB) or, from the beginning, set up as a bridge facility which is intended to be refinanced through the issuance of high-yield bonds or promissory notes (eg, *Schuldscheine*). High-yield bond issues are generally suitable for larger transactions, where the debt will not be repaid quickly (due to the transaction costs and non-call features), although the size of deals being financed with high-yield bonds has become smaller in recent years.

Unitranche financing and term loans granted by debt funds are gaining more and more importance, particularly in the mid-cap segment. Such alternative financings are mostly combined with a super-senior revolving facility provided by a bank. Unitranche providers are often willing to accept higher leverage ratios, since their financing is, from an economic perspective, a combination of senior and mezzanine loans. In turn, the interest rates for unitranche financings are usually higher than for senior loans, since unitranches are priced with an interest rate that is a blend of rates that would have applied to a senior term loan and a mezzanine loan.

In addition to the third-party debt, there is often a form of subordinated shareholder debt, typically in the form of payment-in-kind loans or notes. Some acquisitions also involve a form of vendor loan financing, which is also subordinated to the third-party debt.

Certain funds

4 | Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

From a legal perspective, certainty of funds is only required for take-over offers in relation to listed companies where the consideration is (at least partly) payable in cash. In such cases, the WpÜG requires a confirmation by the financial adviser (or other appropriate third party) that resources are available to the offeror sufficient to pay the compensation if the offer is accepted in full. In addition, the German regulator requires comparable evidence if a purchaser intends to acquire a major stake in a German regulated entity (eg, a bank or financial services institution), although the relevant law does not explicitly require this.

Apart from such requirements, certainty of funding has become market practice for acquisitions of private companies in auction processes. In such scenarios, the relevant bidder negotiates and agrees commitment documents with one or more banks willing to act as underwriters for the required facilities. For more information regarding the content of the relevant commitment documents and the conditions to funding, see questions 23–25.

Restrictions on use of proceeds

5 | Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Transaction documents generally provide for strict rules regarding the purpose and use of the term loans and the proceeds from the issuance of high-yield notes. Usually, the relevant proceeds have to be applied to finance the purchase price, fees and other costs related to the acquisition and financing thereof and the refinancing of the target's existing indebtedness. A violation of the provisions governing the application of funds usually constitutes a breach of contract. Further, the transaction documents usually contain a funds flow statement pursuant to which the relevant proceeds must be transferred directly to certain bank accounts named by the seller and the target's lenders.

Monies utilised under revolving facilities may, as often occurs, be used for general corporate purposes (in addition to the specific uses set out in the purpose clauses). Consequently, the relevant proceeds may be used for a variety of purposes. In the case of syndicated loans, the proceeds of the revolving facility may often also be used to (partially) finance increased original issue discounts (OID) or upfront fees.

Licensing requirements for financing

6 | What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

The granting of loans to third parties in Germany generally requires a banking licence.

On a strict reading of the legislation, this licensing requirement only applies if the lender performs the lending business as a commercial activity or 'on a scale requiring a commercial business organisation'. However, the German Federal Financial Supervisory Authority (BaFin) interprets these thresholds restrictively. It takes the view that a lender performs a commercial activity if it extends a single loan to a German borrower with the intention of extending further loans in the future.

The licensing requirement applies irrespective of the type of borrower and also to entities domiciled outside of Germany who actively target the German market with offers to extend loans. However, no German banking licence is required for entities domiciled in a member state of the EU or the EEA that are licensed to conduct their lending business in and are supervised by the competent authorities of their home member state. In this respect, the passporting provisions for lending under the European Banking Directive CRD IV, as implemented in the German Banking Act, apply.

There are certain exceptions to the banking licence requirement, such as for insurance companies and certain alternative investment funds and their managers. Even if no such exemption applies, non-licensed institutional lenders may acquire loan receivables after the relevant loan has been funded by a bank with a banking licence (ie, the fronting bank solution). However, since the licensing requirement also applies to certain subsequent amendments, such as extensions, adjustments of the interest rate and restructurings, non-licensed entities who acquire loan receivables are essentially limited to the collection and enforcement of the acquired receivables. Alternatively, they can retransfer the relevant loan receivables to a fronting bank for these purposes.

In general, BaFin is in charge of granting licences for the business of lending. However, if the relevant lending vehicle also intends to take deposits, it must be licensed as a deposit-taking credit institution. Such licences are granted by the European Central Bank in consultation with BaFin.

Granting loans without the requisite licence can constitute a criminal offence under the German Banking Act and may even be punished by imprisonment.

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Withholding tax on debt repayments

7 | Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Repayments of principal by a German borrower are generally not subject to German withholding tax. This also generally applies to interest payable by a borrower to a lender under a facility agreement, unless that borrower is a domestic credit institution or a financial service provider. Nonetheless, facility agreements usually contain provisions obliging the borrower to increase payments to compensate for any amount of tax withheld (by way of a tax gross-up) or to indemnify the lender against any tax, costs and expenses incurred as a result of interest payments under the facility agreement (ie, a tax indemnity).

Germany currently does not levy any stamp or documentary taxes on loan and security documentation or loan trading documentation (neither upon execution nor upon enforcement).

In transactions where the borrower or the target has a subsidiary in or another link to the US, US Foreign Account Tax Compliance Act (FATCA) clauses are commonly inserted into the facility agreement. Broadly speaking, FATCA refers to US rules under which US source payments to non-US financial institutions and, potentially, payments between non-US financial institutions can become subject to US withholding tax unless, among other things, certain information has been reported to the relevant tax authorities by the relevant financial institution in relation to those of its account holders that have certain connections to the US. The usual FATCA clauses commonly allocate the risk of US withholding tax under FATCA to the lender.

Restrictions on interest

8 | Are there usury laws or other rules limiting the amount of interest that can be charged?

There are no specific rules limiting the rate of interest in the context of commercial lending.

However, there is a general civil law principle pursuant to which usury loans (ie, loans involving interest or other consideration which is clearly disproportionate to the risk of the relevant loan and which would unfairly enrich the relevant lender), are null and void. However, the threshold for usury is high. It generally requires that the interest rate exceeds the market rate of a comparable transaction by at least 100 per cent.

Further, we note that German law prohibits compound interest (ie, interest on interest). However, this is usually mitigated by compounding accrued interest, which is not paid at the end of the relevant interest period (ie, increasing the principal amount by the relevant interest amount). As a result, interest also accrues on the principal amount as increased by this compounding mechanism.

Indemnities

9 | What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Usually, lenders require indemnity provisions covering various matters, including:

- tax;
- stamp duty;
- conversion of currencies;
- loss to the lenders arising from an obligor's failure to pay or from other defaults under or in connection with any finance document;
- costs in connection with amendments to or granting of waivers in relation to the documentation;
- costs in connection with enforcing or preserving security interests; and
- certain (increased) regulatory costs.

In recent years, lenders have usually also required an indemnification against third parties' claims except in the case where the relevant claim results from the relevant lender's own (gross) negligence or wilful misconduct.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

In the absence of a contractual agreement to the contrary, claims arising from financing agreements may generally be assigned freely by a creditor to another or new creditor. Depending on the identity of the creditor and the circumstances of the individual case, general banking secrecy or data protection provisions may have to be complied with. A breach of these provisions would not render an assignment invalid, but might lead to claims for damages in favour of the debtor only.

However, pursuant to most loan agreements, transfers and assignments require the borrower's consent unless the transfer or assignment is (i) to another existing lender or affiliate or a related fund or entities on a permitted transferee list, or (ii) made while an event of default has occurred and is continuing. Usually, the contractual restriction does not apply to sub-participations unless voting rights are transferred. Transfers to 'competitors', distressed debt funds and sometimes to lenders on a prohibited transferee list or, in the case of revolving credit or guarantee facilities, to lenders below a minimum credit rating are increasingly prohibited in mid- to large-cap financings especially where a strong borrower or sponsor credit is present. Investment-grade loans may impose other restrictions such as a requirement that lenders of working capital are commercial banks or satisfy certain rating criteria.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Whether or not the administrative agent, trustee or collateral agent must be licensed as a banking institution or financial services provider depends on the scope of the relevant role. If the performance of the relevant tasks (taking into account all actions that could conceivably be required during the life cycle of the transaction) comprises banking business or the provision of financial services (eg, payment services), the relevant agent or trustee must have a licence (either in Germany or, if the relevant entity is domiciled in another member state of the EU or the EEA, its home member if the relevant passporting requirements are fulfilled). Consequently, it should be carefully analysed on the basis of the relevant financing documents whether or not the activities of a trustee or agent could qualify as a licensable service.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Under German law, a debt buy-back is generally possible. However, financing agreements usually limit the borrower's and its affiliates' ability to conduct debt buy-back transactions. Debt buy-back transactions by the borrower's holding companies are usually permitted. However, financing agreements often contain disenfranchisement provisions in this regard.

In relation to buy-back of debt securities, other legal or regulatory considerations may also be relevant. This is particularly important if the debt securities being bought back are traded on an EU-regulated

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market, multilateral trading facility (MTF) or organised trading facility (OTF). In this case, it must be ensured that the relevant buy-back complies with, inter alia, the insider dealing provisions set out in the Market Abuse Regulation ((EU)596/2014) and, if set out in the rules of the relevant MTF or OTF (eg, the Luxembourg stock exchange), the principle of equal treatment.

We note that, in the case where the borrower repurchases debt under loan agreements, the assignment or transfer of the repurchased obligations to the borrower may result in their extinguishment, based on the German law principle of confusion (ie, extinguishing due to the identity of the creditor and the debtor). However, there are certain exemptions from this principle, in particular if the relevant claim is securitised in a bond.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Most financing agreements and high-yield bonds permit the borrower or issuer to amend the terms with the consent of the relevant majority. Under specific circumstances, such amendments can be challenged as an oppression of the minority, but the risk is reduced where the parties act in good faith with transparency and the same deal is offered to all parties in the same position and which is not a negative inducement.

In practice, the consent solicitation can be a difficult and lengthy process where there are many creditors who need to provide their consent, for example in high-yield bond transactions or TLBs which are syndicated to numerous institutional investors. A consent solicitation in transactions involving *Schuldscheine* is particularly difficult, since *Schuldscheine* do not have a 'majority lenders' concept and therefore require the consent of each individual creditor.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

German corporate law sets out, inter alia, share capital maintenance rules and prohibits an interference which jeopardises a subsidiary's existence. Such rules primarily apply to payments to direct shareholders. However, they also apply to guarantees provided by an entity for the benefit of its (direct or indirect) shareholder(s) (upstream guarantee) and other subsidiaries of its (direct or indirect) shareholders (which are not simultaneously shareholders of the entity providing the relevant guarantee) (cross-stream guarantees). The relevant limitations apply, inter alia, to German limited liability companies (GmbH), German stock corporations (AGs) and German limited partnerships where a German limited liability company is the sole general partner (GmbH & Co KG).

The relevant limitations do not render the relevant guarantee void, or automatically limit the relevant entities' capacity to make payments under the guarantee. However, the granting of or the payment under an upstream or cross-stream guarantee in violation of the applicable capital maintenance rules can result in a civil (and potentially criminal) liability of the managing directors of the relevant German entity. In practice, these German entities do grant upstream and cross-stream security and guarantees by relying on heavily negotiated limitation language.

The purpose of the limitation language is primarily to protect the guarantor's or security provider's registered capital (based on a balance sheet test), thereby shielding the management from incurring potential personal liability.

In contrast to the above, German law generally imposes no limitations on foreign companies providing guarantees for the benefit of their German affiliates or parents (however, the laws of the relevant foreign jurisdictions usually do).

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

In addition to the restrictions under the capital maintenance rules described in question 14, the provisions on providing financial assistance set out in the German Stock Corporation Act apply if the target is a German stock corporation. Pursuant to these provisions, a stock corporation must not provide any direct or indirect support to the acquisition of its shares. This prohibition also applies to subsidiaries of stock corporations. If the providing of collateral conflicts with such provisions, the relevant agreements may be void. However, there are several recognised ways to circumvent such issues. For example, if a control and profit and loss transfer agreement between the stock corporation and its parent is in force, acts of assistance provided by the stock corporation can be exempt from the aforementioned rules.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

German civil law provides for several types of collateral instruments. These include accessory security interests (ie, security interests that are legally linked to and determined by the secured claims), such as:

- pledges over shares and partnership interests;
- pledges over claims (eg, arising under bank accounts), rights (eg, intellectual property) and goods; and
- mortgages on real estate, ships and aircraft.

In addition, there are non-accessory security interests (ie, security interests that are independent of the existence of the secured claims and which can be transferred without the secured claim) such as:

- assignment of receivables (eg, against customers or intragroup debtors);
- security transfer of title to movable assets;
- guarantees, sureties and letters of comfort; and
- land charges on real estate.

German law does not provide for the possibility of an all asset type security (like a debenture in the UK or an all asset security in the US). Security needs to be granted over each asset type. However, pledges and assignments may also cover future shares, partnership interests or claims, and assignments may also cover future receivables and goods, as long as the future encumbered assets are already identifiable at the time the relevant security agreement is entered into.

Although German law does not generally provide for the concept of floating charges, in certain respects it is possible to agree to security arrangements pursuant to which collateral may float. For example, it is possible to grant blanket assignments of certain assets. Such assignments would have to comply with the principle of certainty, which means that it must be determined, or at least it must be determinable at all times, which exact assets are subject to such assignments.

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Under German insolvency laws, the authority to dispose of an asset ends with the opening of insolvency proceedings, so that from that time on no future assets or receivables will become part of the security.

Requirements for perfecting a security interest

17 | Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

This generally depends on the specific type of security and must be assessed on a case-by-case basis.

For example, an agreement pursuant to which a pledge over the shares in a German limited liability company is created needs to be notarised. In contrast, the notarisation requirement does not apply in relation to pledges over, inter alia, the shares in a German stock corporation. The creation of a pledge over receivables requires the relevant debtor (eg, the account bank) to be notified, whereas the assignment of receivables requires no such notification. However, notifying the debtor may be advisable to ensure that payment is made to the assignee (and not the assignor).

Further, real estate security (eg, land charges) must be registered with the competent land registry.

Renewing a security interest

18 | Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Under German law there are generally no requirements for renewal procedures. However, certain banks require lists itemising the assigned claims to be delivered to them periodically (eg, monthly or quarterly). Such lists are generally not required for the validity of the security, provided that the description of the assigned receivables is sufficiently specific to identify which receivables are being assigned. The lists can, however, help to accelerate a potential enforcement of the security.

Stakeholder consent for guarantees

19 | Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

Generally, no explicit legal provisions exist stating that approval of a works council or other similar consent is necessary before granting a guarantee or security. However, if an economic committee within the meaning of section 106 of the German Works Constitution Act exists (which is required if the relevant entity has more than 100 full-time employees), it might be appropriate to keep that economic committee informed of any relevant borrowing and granting of security, because the company is obliged to inform the committee about economic affairs, in particular the company's economic and financial situation.

Granting collateral through an agent

20 | Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Security can be granted to an agent for the benefit of all lenders. However, in the case of accessory security, this requires the creation of a parallel debt obligation. This is due to the fact that accessory securities may only be granted to the holder of the secured claim and only be enforced in an amount equal to the security holders' secured claims. A parallel debt obligation creates a claim for the security trustee equal to the aggregate amount of all claims outstanding in connection with the secured documents from time to time. This structure is widely used and generally accepted in the German market, even though there is no definitive case law confirming its validity.

As a result, assignments and transfers can be effected by lenders under a facility agreement or the holders of bonds without taking any steps to ensure that the new lender(s) or holder(s) benefit from the underlying German law security interests. However, transfers between lenders by way of novation may extinguish the secured claim under German law and arguably restart the hardening periods. Therefore, transfers by way of novation are typically avoided where German security was granted.

Creditor protection before collateral release

21 | What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

German statutory law does not explicitly deal with creditors' protection before the release of collateral.

Non-accessory security rights, such as a security assignment or transfer, need to be released and the assigned or transferred claims or assets need to be reassigned or re-transferred, as relevant, by way of an agreement between the security grantor and the security holder.

Accessory security, such as pledges, automatically extinguishes if all secured obligations have been discharged in full. Further, a portion of the encumbered assets may automatically be released as a result of overcollateralisation (ie, if the realisable value of the encumbered assets significantly exceeds the value of the secured claims). However, there are certain exceptions, and it is customary that accessory security interests are also explicitly released by means of a release agreement.

Fraudulent transfer

22 | Describe the fraudulent transfer laws in your jurisdiction.

Depending on the circumstances of the individual case, German law provides for several provisions dealing with fraudulent transfers. For example, if a debtor has transferred assets, despite creditors of that debtor being entitled to those assets, owing to an enforceable judgment, these creditors may under certain conditions challenge that transfer in accordance with the provisions of the German Creditors' Avoidance of Transfers Act. Further, in circumstances involving insolvency, the insolvency administrator may contest transactions which were entered into with the intention to disadvantage the debtor's creditors if the other party was aware of such intention and the transaction was entered into during the 10 years prior to the request to open insolvency proceedings. In addition, fraudulent transfers may be deemed criminal offences.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 | What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

Acquisition financing agreements are usually based on standard documentation published by the Loan Market Association (LMA). The LMA also publishes documents governed by German law.

For acquisitions of private companies, a commitment letter attaching a detailed long-form term sheet is generally used as a starting point while full documentation is being prepared in the background. In certain transactions, the commitment documents also contain an 'interim facilities' agreement. Such interim facilities agreements aim to

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provide a fall-back to ensure certainty of funding while full documentation is still being prepared and negotiated. However, in almost all cases, the interim facilities agreement is neither signed nor used for funding, as the parties usually agree on a long-form credit agreement before the acquisition is closed.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Commitment letters for acquisition financings usually provide for underwritten debt. This is particularly true in auction processes, where bids are typically supported by fully underwritten debt. Best efforts commitments are more usual for refinancing transactions or in the context of the issuance of high-yield bonds (which is typically combined with an underwritten bridge loan).

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Conditions precedent contained in the commitment letter generally depend on the certain funds basis required for the offer as well as the duration of the commitment. The conditions are usually quite limited and comprise, inter alia, the execution of final documentation within a certain period of time, the granting of the agreed security interests, the injection of the equity portion and shareholder loans and the absence of a major default (ie, a default resulting from the breach of certain particularly important representations and undertakings relating to the actions or omissions of the acquiring group companies (and not the target group)). In a typical acquisition financing, lenders are provided with draft due diligence reports, a draft acquisition agreement and all required KYC documents prior to signing the commitment documents.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Banks often ask for market flex clauses, allowing them to modify the agreed terms of the loan unilaterally if syndication turns out to be more difficult than expected. Such flex usually permits arrangers to increase the margin, original issue discounts or upfront fees, as well as to reduce the size of certain baskets or to delete growers or make other changes to the financing structure, pricing and financial maintenance covenants (if any).

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demands are sometimes seen in acquisition financings in Germany, depending on the then current market conditions and size of the bridge loan. Alternatively, bridge facility agreements often provide for factual requirements (such as the short maturity) or incentives (such as significant margin step ups after the lapse of a certain period of time) to refinance the bridge facility by means of securities or a term loan B (TLB).

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Lenders usually focus on the payment mechanics (eg, agreements on deferred purchase prices or deposits, if any), the purchase price formula (eg, locked box or closing accounts), the closing conditions and procedures, the long stop date, the termination rights, the representations and warranties and any vendor rights surviving closing (including vendor financing). Lenders usually require control over the purchaser's ability to amend or waive the related provisions of the acquisition agreement.

Further, lenders usually require that the purchaser's rights under the acquisition agreement can be assigned to the lenders. In addition, purchasers are often required to ensure that the acquisition agreement requires the seller and the target to cooperate in the syndication process and that the agreement as well as any related documents can be disclosed to the lenders and potential assignees or transferees.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

In the context of acquisitions of private companies, there is no requirement to file commitment letters or acquisition agreements. In the context of a public takeover offer, the relevant offer document must be published. In addition, if the relevant offer provides for a cash payment as consideration, an investment services enterprise that is independent of the offeror must confirm in writing that the offeror has taken the steps necessary to ensure that the means required to perform the offer in full are available at the time at which the claim for cash payment falls due. However, this does not require that the relevant commitment letter is publicly filed.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Prior to the filing of an insolvency petition, the ability of lenders to enforce against the collateral is unrestricted. Limited exceptions exist pursuant to the general principles of German civil law, which are determined on a case-by-case basis.

Upon the filing of an insolvency petition, the insolvency court can take preliminary protective measures to secure the assets of the debtor during preliminary insolvency proceedings. This may include a suspension of enforcement measures. The same applies if the insolvency court initiates a protective shield proceeding. However, such proceedings may only be initiated if specific conditions are met and the debtor simultaneously applies for self-administration.

Upon the opening of main insolvency proceedings, any judicial enforcement action brought against the debtor by any of its creditors is subject to an automatic stay. Whether or not a secured creditor remains entitled to enforce collateral depends on the type of collateral.

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Debtor-in-possession financing

31 | Does your jurisdiction allow for debtor-in-possession (DIP) financing?

German insolvency law provides for a legal concept comparable to the US 'debtor-in-possession' concept. On the debtor's application and, subject to certain conditions being met, in particular that no disadvantages for the creditors are to be expected, the competent insolvency court may entitle the debtor to continue to manage and dispose of the assets involved in insolvency proceedings. However, the court will appoint a supervising administrator. In addition, German insolvency law provides for the possibility of shield proceedings. The objective of a protective shield proceeding is to protect the debtor from foreclosure measures, and to give them the opportunity to develop an insolvency plan to be implemented in a subsequent insolvency proceeding. Protective shield proceedings may only be granted in combination with an application for self-administration. Further, such an application must be accompanied by reasons for the application from a person experienced in insolvency matters, which confirm that the debtor is imminently illiquid or over-indebted, but not yet illiquid, and that the envisaged restructuring has prospects of success. If protective shield proceedings are granted, the debtor may continue management on an in-possession basis in order to follow the rescue concept by being protected against any creditor enforcements.

Stays and adequate protection against creditors

32 | During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

During preliminary insolvency proceedings, insolvency courts usually order a prohibition, or a provisional restriction, on a compulsory enforcement against an unsecured creditor, except where immovable property is concerned.

Upon the opening of insolvency proceedings, unsecured creditors are barred from enforcing their claims and may only file their claims with the insolvency administrator. Whether or not secured creditors remain entitled to enforce collateral upon the opening of insolvency proceedings depends on the type of collateral, on who has possession over the relevant asset and whether or not the relevant security interest qualifies as 'financial collateral' within the meaning of the German Banking Act. If the insolvency administrator is entitled to enforce the relevant collateral (eg, in respect of claims that the debtor has assigned for security purposes), it is entitled to withhold certain fees (in practice, a minimum of 9 per cent of the enforcement proceeds).

Clawbacks

33 | In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders? What are the rules for such clawbacks and what period is covered?

German insolvency law provides for several avoidance rights pursuant to which the insolvency administrator may challenge transactions (including loan repayments or the creation of security interests) entered into within certain periods of time prior to the initiation of insolvency proceedings. The requirements differ depending, inter alia, on whether these transactions were entered into at arm's length or not and on the time lag between such transactions and the application for insolvency proceedings.

The most relevant period for insolvency avoidance is the period of three months prior to the application for insolvency proceedings. However, there are significantly longer avoidance periods if certain criteria are met. For example, the avoidance period for transactions entered into by the debtor with the intention to disadvantage its creditors and where the other party was aware of such intention is 10 years. Further, specific rules apply to security interests acquired via a public enforcement.

Ranking of creditors and voting on reorganisation

34 | In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Creditors are usually ranked as follows:

- creditors with a right to separation (eg, because of legal and beneficial ownership);
- creditors with a right to separate satisfaction (eg, secured creditors);
- preferential creditors (consisting of, inter alia, creditors entitled to claims arising from continued urgent business transactions, court costs as well as fees and costs of the administrator);
- unsecured creditors;
- subordinated creditors (eg, due to a subordination agreement confirming that the subordinated creditor will only receive payment once all other (unsecured) creditors have been satisfied); and
- shareholders (with their claim to the repayment of capital or a liquidation surplus).

German insolvency law provides for an insolvency plan procedure in order to reorganise the business and enable the enterprise to continue as a going concern. The relevant provisions of the German Insolvency Code have recently been amended to encourage the use of this feature. In this respect, the rights of creditors have been strengthened and hurdles to reject an application by the debtor for self-administration proceedings have been increased. The plan must be approved by a vote of the majority creditors of each relevant class or group and the shareholders. Even if individual groups do not approve the plan, such refusal can be overcome if the competent insolvency court holds that the plan does not worsen that particular group's position compared to its situation in the absence of an insolvency plan and if the plan provides such group's members with a reasonable economic share of the assets that are to be distributed on the basis of the insolvency plan (the 'cram-down rule'). Therefore, the grouping of creditors is of strategic importance.

Intercreditor agreements on liens

35 | Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

The priority of liens depends on the time the relevant lien is created. However, secured creditors may freely agree on the application of enforcement proceeds among themselves. Such agreements are usually contained in the intercreditor agreement, requiring the security agent or trustee to enforce the transaction security and distribute the enforcement proceeds to the various secured creditors in accordance with their rankings.

Discounted securities in insolvencies

36 | How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

German insolvency law does not explicitly deal with the treatment of claims arising from an original issue discount. Therefore, the aforementioned general principles of German insolvency law would apply.

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Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

German law does not provide for liabilities comparable to those known under the United States Federal Comprehensive Environmental Response, Compensation and Liability Act.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports.

There is new real estate transfer tax (RETT) legislation pending. This legislation aims to make it more difficult to implement RETT neutral transfers of shares in a company holding real estate situated in Germany and lengthens specific clawback periods. If the new legislation comes into force, the relevant implications will have to be considered when structuring the acquisition financing in relation to a target holding real estate in Germany.

TLBs broadly syndicated to banks and institutional lenders have become more common in German acquisition financings. The covenants under such TLB loan agreements are becoming increasingly similar to covenants commonly seen in US-style loans and New York law governed high-yield bonds. Such covenant lite loans are becoming increasingly common for German acquisition financings.

The German acquisition finance market is very robust. This chapter provides an overview of the German acquisition loan and bond market. It addresses certain key issues which should be considered when structuring and executing an acquisition financing in Germany. It describes traditional loan and bridge financings as well as high-yield bonds. The chapter also discusses more recent trends such as Term Loan Bs and unitranche financings. To this extent, it also discusses banking supervisory law issues relevant for Debt Funds and other non-bank lenders. In light of the large cross-border market, the chapter also elaborates on the interaction between German and foreign laws. In this context, key issues in relation to collateral granted over the shares in German companies, receivables governed by German law and other property situated in Germany are described. The chapter also discusses corporate law issues and their implications on financing transactions, including the relevance of German limitation language. In addition to the original financing, the chapter also provides an overview of potential issues which arise when considering a debt restructuring. In contrast to a consensual restructuring, the chapter also discusses insolvency law implications and the possibility of a German insolvency plan.

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