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Germany

ACQUISITION FINANCE

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This country-specific Q&A provides an overview of acquisition finance laws and regulations applicable in Germany.

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GERMANY
ACQUISITION FINANCE

1. What are the trends impacting acquisition finance in your jurisdiction and what have been the effects of those trends? Please consider the impact of recent economic cycles, Covid-19, developments relating to sanctions, and any environmental, social, and governance ("ESG") issues.

In the past year, the German M&A market was clearly negatively affected by a number of factors which included (i) the significant increase in interest rates, (ii) reduced confidence by consumers and (iii) developments in international politics resulting in armed conflicts and sanctions. These developments resulted mainly in a decrease in international and larger transactions while, on the other hand, the deal flow in smaller and mid cap transactions in the German and DACH market was more stable. The trend that market participants become much more selective with a clear focus on transactions in tech-driven markets and transactions with an ESG-focus has continued and increased. Another example for a very active field in German PE was the consolidation of highly fragmented markets.

2. Please advise of any recent legal, tax, regulatory or other developments (including any reforms) that will impact foreign or domestic lenders (both bank and non-bank lenders) in the acquisition finance market in your jurisdiction.

In the past year, the main trends in the German market for M&A-transactions and acquisition financings have been mainly set by market developments (such as increased interest rates and awareness for sustainability and ESG-factors) and only to a lesser extent by legal and regulatory reforms or developments. Market trends, including increased interest rates and a growing emphasis on sustainability and ESG factors, have played a significant role in shaping transactional trends. These market developments have affected foreign and domestic lenders in the acquisition finance market, impacting the structuring and execution of acquisition financings.

3. Please highlight any specific high level issues or concerns in your jurisdiction that should be considered in respect of structuring or documenting a typical acquisition financing.

Apart from general considerations, lenders will focus on how the cashflow of the target is made available to service debt requirements and how an access to security would work in an enforcement scenario. This is in particular relevant if the structure is tailormade in a certain respect (e.g., if the target is a German stock corporation (Aktiengesellschaft, AG)) or where minority shareholders are or remain in the corporate structure. In certain cases, regulatory requirements will affect the structure (e.g., that certain health care companies may only be directly held by hospitals) and lenders should analyse the effect of such requirements in detail.

4. In your jurisdiction, due to current market conditions, are there any emerging documentary features or practices or existing documentary provisions/features which borrowers or lenders are adjusting or innovating their interpretation of, or documentary approach to?

Generally, it is probably fair to say that lenders have become more careful when structuring transactions and their legal documentation and have also regained some bargaining power to request more control and protection than the past years. Therefore, as a general trend, the financing documents have become more conservative in the recent past.

5. What are the legal and regulatory requirements for banks and non-banks to be authorised to provide financing to, and to benefit from security provided by, entities established in your jurisdiction?

Generally, lending (i.e., the disbursement of loans, including to corporate borrowers and in connection with acquisition financings) is a regulated activity in Germany. However, the legal regime has been relaxed for debt funds (in the form of alternative investment funds). As a short summary, granting loans to non-consumers would be permitted if such transactions are permitted under the legal regime and investment strategy of the fund. In addition, exceptions from the licensing requirement apply where lending is performed by a non-German lender as non-solicited service to a German borrower.

6. Are there any laws or regulations which govern the advance of loan proceeds into, or the repayment of principal, interest or fees from, your jurisdiction in a foreign currency?

Apart from sanctions under German or European laws or other specific circumstances, there are no restrictions in place. These restrictions do not play a major role in leveraged transactions. However, cross border payments exceeding certain thresholds have to be reported to the German Bundesbank for statistical purposes.

7. Are there any laws or regulations which limit the ability of foreign entities to acquire assets in your jurisdiction or for lenders to finance the acquisition of assets in your jurisdiction? Please include any restrictions on the use of proceeds.

Generally, no such restrictions apply with respect to financed/acquired assets. Exceptions apply in case of a proposed acquisition of "critical infrastructure" which has to be notified to, and may be prohibited by, the German Federal Ministry of Economics (Bundeswirtschaftsministerium). In addition, regulatory provisions may require certain licenses/qualifications for shareholders. As an example, this may be relevant in the health care and the financial services and insurance sector.

8. What does the security package typically consist of in acquisition financing transactions in your jurisdiction and are there any additional security assets available to lenders?

On the level of the acquisition company, lenders usually take the following security pre-closing:

- *Pledge of the shares (i) in the acquisition company and (ii) in the target (shares to be acquired)*
- *Pledge of bank account(s)*
- *Assignment of receivables (from acquisition agreement, reports and potentially W&I insurance)*
- *Subordination (and potentially assignment) of shareholder loans, depending on funding structure*

On the level of the target, lenders usually take security over material assets, including:

- *Pledge of bank account(s)*
- *Assignment of receivables (in particular trade receivables)*
- *If relevant, movable assets, intellectual property, real property, shares in (material) subsidiaries.*

Where the acquisition financing does not also cover working capital, the acquisition financing may have to leave certain assets unencumbered to allow the borrower to implement working capital financing. As an alternative, an intercreditor agreement may be entered into.

9. Does the law of your jurisdiction permit (i) floating charges or any other universal security interest and (ii) security over future assets or for future obligations?

We do not have the legal concept of floating charges in Germany. Since the requirements with respect to granting security over the various types of assets are different, it is customary to use a separate security document for each type of assets (e.g., bank accounts, receivables, moveable assets etc.). Security over future assets and for future obligations can be agreed, subject to (i) the proper identification of the relevant asset and/or obligation in the relevant security document and (ii) insolvency law limitations with respect to (future) assets coming into existence immediately prior to (or after) an insolvency.

10. Do security documents have to (by law) include a cap on liabilities? If so, how is this usually calculated/agreed?

No cap is required in the security documents. However, the value of collateral (to be calculated in the basis of the so-called realisable value (realisierbarer Wert)) that can be taken as security is limited by German usury laws (anfängliche Übersicherung). In addition, German courts have developed legal principles requiring a (partial) release of security if and when the realisable value of the collateral exceeds the amount of secured obligations during the term of the loan (nachträgliche Übersicherung).

11. What are the formalities for taking and perfecting security in your jurisdiction and the associated costs and timing? If these requirements are different for different asset classes, please outline the main points to note for each of these briefly.

Type of Security	Formalities	Costs/Timing
Share pledges	For shares in limited liability companies (GmbHs), being the most common legal form in Germany, share pledges require notarial form (Beurkundung).	Notarisation of share pledge triggers notary fees which may be substantial. No timing constraints.
Bank account pledges	Account bank has to be notified of the pledge, and will be asked to waive/subordinate the pledge granted pursuant to its general business terms.	No costs or timing constraints.
Assignment of (trade and other) receivables	Assignment of receivables may be silent, i.e., not disclosed to the debtor. However, it is customary to disclose the assignment vis-à-vis specific debtors which can be made aware of the transaction without affecting the borrower's business operations.	No costs or timing constraints.
Security transfer of moveable assets	The relevant assets have to be described in a very precise way in the security document (e.g., by adding a map of the premises). Where goods are not stored on own premises and/or are mingled with assets of third parties, taking security may be difficult.	No costs or timing constraints.
IP pledge or assignment	Formalities and notice requirements depend on the type of security.	No costs or timing constraints.
Real property	Requires a notarial deed to grant the land charge (with submission to immediate enforcement) and the registration of the land charge with the land registry.	Notarisation and registration triggers notary and registration fees which can be substantial. No timing constraints, registration of land charge may happen subsequently.

12. Are there any limitations, restrictions or prohibitions on downstream, upstream and cross-stream guarantees in your jurisdiction? Please also provide a brief description of any potential mitigants or solutions to these limitations, restrictions or prohibitions.

The limitations for German entities to grant upstream- and cross-stream guarantees result from corporate law regimes of the relevant entities and, more specifically, from capital maintenance provisions. Hence, they depend on the legal form of the guarantor:

- *For German limited liability companies (GmbHs), an upstream/cross-stream guarantee may lead to a violation of capital maintenance provisions if the enforcement of the guarantee may cause the GmbH's net assets to fall below its registered share capital.*
- *Similar requirements apply to limited partnerships (KGs) having a GmbH as their general partner.*
- *German stock corporations (AGs, including a Societas Europaea, SE) may normally not grant upstream/cross-stream guarantees since AGs are only permitted to distribute their annual profit to their shareholders.*

Therefore, upstream guarantees usually contain a so-called "limitation language" which limit the enforcement of the guarantee(s) to the extent allowed under applicable corporate laws.

Subject to exceptions, the limitation language will provide that the guarantee is unlimited, if a so-called domination/profit and loss transfer agreement (Beherrschungs- und/oder Ergebnisabführungsvertrag) has been agreed between the Guarantor and its shareholder. In this case, German corporate laws provide that the capital maintenance rules do not apply. These agreements are often implemented post-closing to create a tax unity between acquisition company and target, and also will mitigate the effects of the limitation language. In the best case, the guarantee will then (generally) be unlimited.

We note that recent case law of the German Federal Court of Justice (Bundesgerichtshof) has clarified a number of aspects of limitation languages. However, since a number of questions remained open in the relevant decisions, a limitation language is still customary.

From a tax perspective, borrowers normally analyse if

the Guarantor should receive a compensation for granting the guarantee.

No limitations apply for downstream guarantees.

13. Are there any other notable costs, consents or restrictions associated with providing security for, or guaranteeing, acquisition financing in your jurisdiction?

There are no costs which are specifically associated with guarantees/security for an acquisition financing. The general costs for taking security over the different assets are described above.

14. Is it possible for a company to give financial assistance (by entering into a guarantee, providing security in respect of acquisition debt or providing any other form of financial assistance) to another company within the group for the purpose of acquiring shares in (i) itself, (ii) a sister company and/or (iii) a parent company? If there are restrictions on granting financial assistance, please specify the extent to which such restrictions will affect the amount that can be guaranteed and/or secured.

Generally, the limitations as described above for guarantees apply also with respect to upstream/cross-stream security: Acquisition debt may be secured/guaranteed by the target subject to an applicable limitation language. Stock corporations (AGs) cannot guarantee/secure obligations of a parent company (subject to the exception described above), and the German Stock Corporation Act (Aktiengesetz) contains also specific provisions on financial assistance aspects.

15. If there are any financial assistance issues in your jurisdiction, is there a procedure available that will have the effect of making the proposed financial assistance possible (and if so, please briefly describe the procedure and how long it will take)?

The effects of the limitation language can be overcome or mitigated by a number of post-closing steps:

- *The most common procedure is the implementation of a domination/profit and loss transfer agreement (Beherrschungs- und/oder Ergebnisabführungsvertrag). If the limitation language in the guarantee/security documentation is properly drafted, this improves the access to the target security/guarantee for the lender (as described above in more detail).*
- *In other cases, the structural subordination may be addressed a merger between the acquisition company and the target and/or a debt push down to the target. These alternatives may require that certain balance sheet ratios are complied with and may be influenced by tax requirements.*
- *Targets which are stock corporations (AGs) are often converted into GmbHs after closing.*

16. If there are financial assistance issues in your jurisdiction, is it possible to give guarantees and/or security for debt that is not pure acquisition debt (e.g. refinancing debt) and if so it is necessary or strongly desirable that the different types of debt be clearly identifiable and/or segregated (e.g. by tranching)?

The limitation language (if properly drafted in accordance with the German market practice standards in financing transactions) applies to the financing which has not been made available and/or passed on to the target. Therefore, it is indeed beneficial to lend directly to the target where possible (e.g., for working capital or add on acquisitions).

17. Does your jurisdiction recognise the concept of a security trustee or security agent for the purposes of holding security, enforcing the rights of the lenders and applying the proceeds of enforcement? If not, is there any other way in which the lenders can claim and share security without each lender individually enforcing its rights (e.g. the concept of parallel debt)?

Yes, the concept of a security trustee/agent is commonly used in German syndicated financings, based on documentation as customary in international transactions. However, as a technical matter, German laws distinguish between so-called accessory security

(i.e., pledges over accounts, shares and IP) and non-accessory security (i.e., security over receivables, equipment/inventory and real estate). While non-accessory security can be held by a trustee for the security creditor, the accessory security can only be held by the creditors of the secured claims. Therefore, the trustee-provisions should include a parallel debt claim for the Security Agent, and/or the documentation should provide that accessory security is held by the creditors and is only administered by the Security Agent.

18. Does your jurisdiction have significant restrictions on the role of a security agent (e.g. if the security agent in respect of local security or assets is a foreign entity)?

No legal restrictions exist for security agency (assuming that the tasks of the Security Agent would not involve the provision of regulated payment services).

19. Describe the loan transfer mechanisms that exist in your jurisdiction and how the benefit of the associated security package can be transferred.

Loan agreements governed by German laws may provide for a transfer of the entire contractual relationship of the transferring lender by a transfer/assumption of contract (Vertragsübernahme) and/or for an assignment of the fully disbursed loan of the transferring lender by assignment (Abtretung). If the documentation is properly drafted, the relevant security (to the extent held by the lender itself and not by the security trustee) will transfer automatically.

If the loan agreement is governed under a foreign law, it has to checked in the specific case if a transfer would negatively affect the existing security (e.g. in case of a transfer by novation under English laws).

20. What are the rules governing the priority of competing security interests in your jurisdiction? What methods of subordination are used in your jurisdiction and can the priority be contractually varied? Will contractual subordination provisions survive the insolvency of a borrower incorporated in your jurisdiction?

From a perspective of civil and insolvency laws, the priority of competing security interests is generally governed by the time when the security has been granted. However, creditors may, as a contractual matter among themselves, agree on a distribution of the enforcement proceeds which may be different from the ranking of security.

With respect to secured claims, creditors may, as a contractual matter, agree on a subordination of certain claims vis à vis other claims. In addition, German law provides for a so-called qualified subordination (qualifizierter Rangrücktritt) where a creditor subordinates its claims to all other creditors to the level immediately before the equity. This is a typical structuring element of shareholder loans.

Both kinds of subordination are also respected also in an insolvency of the borrower (noting that the contractual subordination will be primarily a matter between the creditors).

21. Is there a concept of “equitable subordination” in your jurisdiction whereby loans provided by a shareholder (as a creditor) to a company incorporated in your jurisdiction are subordinated by law upon insolvency of that company in your jurisdiction?

Yes. Under the German Insolvency Code (Insolvenzordnung), shareholder loans are, subject to limited exceptions, subordinated to all other creditors in an insolvency of the borrower/subsidiary. This concept of subordination also involves that security granted by the relevant subsidiary, as well as repayments made by the subsidiary within one year from an insolvency, may be challenged, i.e., clawed back in an insolvency.

22. Does your jurisdiction generally (i) recognise and enforce clauses regarding choice of a foreign law as the governing law of the contract, the submission to a foreign jurisdiction and a waiver of immunity and (ii) enforce foreign judgments?

Yes, but subject to the limitations based on applicable European and German laws with respect to mandatory provisions and ordre public. In practice, these restrictions do not play a significant role in normal financing transactions.

23. What are the requirements,

procedures, methods and restrictions relating to the enforcement of collateral by secured lenders in your jurisdiction?

The enforcement varies for the different types of collateral:

- *One important aspect is that pledges over shares (except if listed) must be enforced by way of a public and/or notarial auction (unless the pledgor agrees to a private sale). Share security is only enforced in rare cases.*
- *The second practical aspect is that asset security is in most cases enforced while the borrower is subject to insolvency proceedings, given that the acceleration/maturity of the loan will likely force the borrower to apply for insolvency. If so, the enforcement will be highly influenced by insolvency laws, providing, inter alia, that certain kinds of security are enforced by the insolvency receiver.*

24. What are the insolvency or other rescue/reorganisation procedures in your jurisdiction?

German insolvency laws provide for regular insolvency proceedings in which a court-appointed insolvency receiver (Insolvenzverwalter) is controlling the proceedings. In many cases, these proceedings lead to a sale of the business (or certain parts thereof) in an M&A-transaction. The main alternative to the regular proceedings are debtor in possession proceedings (Eigenverwaltung) where the management of the insolvent debtor remains in control of the process and, being supervised by a trustee (Sachwalter) and the insolvency court, often envisages to implement a so-called insolvency plan (Insolvenzplan). Recently, the German legislator introduced so-called pre-insolvency restructuring proceedings (vorinsolvenzliches Sanierungsverfahren).

25. Does entry into any insolvency or other process in your jurisdiction prevent or delay secured lenders from accelerating their loans or enforcing their security in your jurisdiction?

For certain types of security, the insolvency receiver is entitled to enforce the security and will (subject to a certain haircut for the insolvent estate) release the proceeds to the secured creditors. Therefore, from a perspective of the secured creditors, an insolvency will affect and delay the enforcement of security. An acceleration of loans (as a general matter and subject to exceptions) is not delayed, but claims may not be enforced in litigation, but only in the course of the insolvency proceedings.

26. In what order are creditors paid on an insolvency in your jurisdiction and are there any creditors that will take priority to secured creditors?

Subject to limited exceptions and the secured creditors being entitled to the proceeds of their security, all insolvency creditors (i.e., obligations of the insolvent debtor) have the same priority. The obligations entered into by the insolvency receiver during the insolvency procedures rank ahead of the insolvency claims.

27. Are there any hardening periods or transactions voidable upon insolvency in your jurisdiction?

Yes, different hardening periods apply under German insolvency laws under certain circumstances. In financing transactions, no general hardening periods would apply if a lender (in connection with the disbursement of a new financing) takes adequate security, as determined in some detail in the loan agreement.

Specific examples where hardening periods may become relevant include if additional security is taken during the term of the loan. In addition, technical issues may become relevant in connection with so-called revolving security interests where newly created receivables become part of the security package on a permanent basis.

28. Are there any other notable risks or concerns for secured lenders in enforcing their rights under a loan or collateral agreement (whether in an insolvency or restructuring context or otherwise)?

When enforcing rights or security, secured lenders should be aware of the general liability risks which occur in this situation. In particular, an exercise of lenders' rights needs to be based on a diligent analysis that the relevant rights (continue to) exist. In an enforcement of security, lenders need to be careful to follow the legal requirements for the enforcement of the relevant type of security and to be able to demonstrate that they have set up an enforcement procedure to achieve adequate

proceeds (subject to the provisions of the security documentation).

29. Please detail any taxes, duties, charges or related considerations which are relevant for lenders making loans to (or taking security and guarantees from) entities in your jurisdiction in the context of acquisition finance, including if any withholding tax is applicable on payments (interest and fees) to lenders and at what rate.

As a general matter, apart from general corporate income tax of the lender in its tax residency, there are no specific tax aspects for lenders. Exceptions apply if (i) the loan is secured by German real estate or (ii) the interest payable is dependent on the profit or economic performance of the borrower.

30. Are there any other tax issues that foreign lenders should be aware of when lending into your jurisdiction?

Please see above. In addition, lenders should confirm that the loan documentation contains adequate protection against tax risks (i.e., gross up and indemnities).

31. What is the regulatory framework by which an acquisition of a public company in your jurisdiction is effected?

The regulatory framework is mainly contained in the German Takeover Act (Wertpapiererwerbs- und Übernahmegesetz) and the Stock Exchange Act (Börsengesetz). The German Takeover Act plays a pivotal role in regulating the acquisition process, outlining obligations for the acquirer, target company, and other relevant shareholders.

32. What are the key milestones in the timetable (e.g. announcement, posting of documentation, meetings, court hearings, effective dates, provision of consideration, withdrawal conditions)?

The bidder has to publish its intention to make a voluntary or (after having acquired control over the relevant target) a compulsory offer without undue delay. Thereafter, within eight weeks, the bidder has to submit an offer document to the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)). After review and approval by the BaFin, the offer document has to be published without undue delay and, upon such publication, it constitutes a valid offer to the shareholders of the target to acquire their shares.

The consideration offered has to be fair and must not fall below the minimum consideration provided in the Takeover Act. This minimum is based on the average trading price over the last 30 days for voluntary offers and the last 60 days for mandatory or delisting offers. The consideration may be provided in the form of either cash or listed shares at the discretion of the bidder.

The offer period is set by the bidder and must be a minimum of four weeks, with the flexibility to extend up to ten weeks at the bidder's discretion. In the case of a voluntary offer, the offer period can be extended by an additional two weeks after the publication of the tendered shares.

33. What is the technical minimum acceptance condition required by the regulatory framework? Is there a squeeze out procedure for minority hold outs?

No minimum acceptance requirement applies.

Squeeze out mechanisms exist and are generally available if the bidder holds at least 95% of the shares. In addition to the general squeeze out proceedings under general corporate laws, the Takeover Act provides for a modified procedure. In particular, a squeeze out does not require a shareholder resolution being passed and the calculation for the compensation is simplified. At what level of acceptance can the bidder (i) pass special resolutions, (ii) de-list the target, (iii) effect any squeeze out, and (iv) cause target to grant upstream guarantees and security in respect of the acquisition financing?

Generally, resolutions can be passed in accordance with general corporate laws, i.e., based on a simple or qualified (75%) majority of the votes. However, under certain circumstances, minority shareholders have to be compensated if a resolution passed by a majority shareholder significantly impacts them.. This is particularly applicable when a domination and/or profit and loss transfer agreement (Beherrschungs- oder Ergebnisabführungsvertrag) is entered into.

A delisting can be effected after a public takeover offer has been made and is not depending on a specific

acceptance.

For the squeeze out, please see above.

Upstream guarantees and security can be granted by a German stock corporation (AG) after a domination and/or profit and loss transfer agreement (Beherrschungs- oder Ergebnisabführungsvertrag) has been entered into. (Please see above.) This requires a qualified majority of the votes (75%).

34. At what level of acceptance can the bidder (i) pass special resolutions, (ii) de-list the target, (iii) effect any squeeze out, and (iv) cause target to grant upstream guarantees and security in respect of the acquisition financing?

N/A

35. Is there a requirement for a cash confirmation and how is this provided, by who, and when?

The bidder has to provide evidence, by way of a confirmation issued by a bank, financial services provider or certain other qualified entities, that funds are available to it to consummate the offer.

36. What conditions to completion are permitted?

The offer is typically required to be irrevocable, although it may be contingent upon certain conditions, excluding those within the control of the bidder. For a delisting offer, no conditions are permissible. Common conditions for other offers may encompass achieving a specified minimum acceptance threshold and/or securing necessary regulatory licenses.

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