Germany

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

1.1 Market trends and recent developments

The German M&A market has been a seller-friendly environment during the past decade. This trend has intensified in recent years since an increasing number of interested parties met a comparatively small group of potential targets.

The Covid-19 pandemic had only minor short-term effects on the M&A market in spring 2020, followed by a fulminant increase in M&A activities from May 2020 onwards. The recent increases in interest rates by reserve banks around the world are expected to have a more significant impact on the M&A market and the financing of transactions.

1.2 Legal landscape regarding M&A transactions

1.2.1 General legal framework

Germany does not have specific legislation governing private M&A transactions. Instead, a variety of statutes apply, *inter alia*, in the areas of civil law, trade law, corporate law and employment law. Some rules are mandatory (in particular around employment law) and, therefore, cannot be derogated from in the transaction agreements.

1.2.2 Regulatory environment

From a general point of view, the most important aspects to be considered in connection with an M&A transaction are merger control and foreign investment control requirements:

Merger control
Where certain (turnover) thresholds are met, M&A transactions are subject to review by the relevant competition authorities in view of potential impediments of effective competition on relevant markets. Depending on the relevant turnover, filings may be required (primarily) with the German Federal Cartel Office (Bundeskartellamt) or, in the case of larger transactions, the European Commission. In either of these proceedings, the transaction may not be implemented before clearance is obtained. Besides filings with the German Federal Cartel Office or the European Commission, merger control filings may also be required in other countries, if the relevant thresholds for merger control clearance in those jurisdictions are met.

Foreign investment control
German foreign investment control law is designed to protect the public security interests of Germany and the European Union. German foreign investment control laws have been amended and tightened several times over the last couple of years. The following rules apply to investors not domiciled in the EU (non-EU investors); investors from countries that are part of EFTA (Norway, Switzerland, Iceland, Liechtenstein) are treated as EU investors. Currently, there are two regimes for the foreign investment control:

(a) Regardless of the target's business sector, any transaction by which a non-EU investor directly or indirectly acquires at least 25 per cent of the voting rights in a German entity is subject to review by the German Ministry for Economic Affairs and Climate Protection. The transaction may be pursued without prior clearance, but the Ministry may retroactively order the unwinding of the transaction. The Ministry is, therefore, often asked to provide a confirmation that the transaction does not adversely affect the public security interests of Germany or the European Union.

(b) If the target company operates a business relating to critical infrastructure and to any of the other sensitive business areas listed in the relevant legislation, there is a mandatory filing requirement with the German Ministry for Economic Affairs and Climate Protection if a non-EU investor acquires at least 10 per cent of the voting rights in a relevant German entity. Consummation of the transaction without clearance from the Ministry is prohibited and violations constitute a criminal offence.

Irrespective of the regime, the relevant threshold is calculated separately at each level of shareholding. For example, if an entity acquires 30 per cent of a German company and a non-EU investor holds 30 per cent in the acquiring entity, the non-EU investor is considered to acquire more than 25 per cent of the voting rights in the German company. This would be different if the non-EU investor held only 20 per cent in the acquiring entity.

Additional governmental approvals may be required in very sensitive sectors, eg, where weapons manufacturers, certain IT-related businesses and financial institutions are involved. In such cases, clearance requirements also apply to investors domiciled in the EU who intend to acquire at least 10 per cent of the voting rights in a relevant German entity.

2. STRUCTURES FOR PRIVATE M&A TRANSACTIONS

2.1 Types of M&A transactions

Private M&A transactions in Germany are usually conducted as share deals or asset deals. If the divested business is not yet held by a separate legal entity, a carve-out will be required – ie, the seller separates the relevant business prior to or in parallel with the transaction with the purchaser (see below).

The German Transformation Act also provides for a merger of two separate legal entities or a spin-off of parts of an entity. A third-party M&A transaction is usually not structured as a merger or spin-off. However, sellers sometimes use a merger or spin-off ahead of the transaction with the third party in order to create the target group. In practice, a transfer of individual assets, contracts and liabilities, eg, by way of a group internal asset deal or contribution, occurs as frequently as a merger or spin-off.

The advantage of a merger or spin-off is that contracts and liabilities transfer by operation of law without need for consent from contract partners. In case of a spin-off, however, the involved legal entities bear joint and several liability for a period of five years (or ten years for pension liabilities) which sellers and purchasers often consider as an obstacle.

2.2 Share deals

2.2.1 Structure

A share deal is the common and straightforward transaction structure if the sold business is already conducted by a separate legal entity. In a share deal, the seller divests the shares in the target company.

2.2.2 Formal requirements

The sale and the transfer of shares in a German limited liability company (GmbH) requires notarisation, generally by a German notary. Notarisations in Austria or parts of Switzerland were popular (for cost reasons) some years ago, but there is increasing dispute whether such notarisations meet the formal requirements. Thus, in practice, agreements of this kind are notarised in Germany.

No formal requirements apply to the sale and transfer of shares in stock corporations (AG) or partnerships (oHG, KG). However, for reasons of evidence, transactions of this kind are usually entered into in writing.

2.3 Asset deals

2.3.1 Structure

An asset deal is generally used where the target business is not yet conducted by a separate legal entity or only part of the business conducted by the relevant legal entity shall be sold. An asset deal involves the sale and transfer of the assets (real estate, tangible assets and intellectual property), contracts and liabilities pertaining to the target business.

Asset deals are typically more complex than share deals because the object of the transaction must be defined in detail in the purchase agreement. Implementing an asset deal is also more complex than implementing a share deal. *Inter alia*:

- Transfers of contracts and liabilities require the approval of the counterparty for the seller to be released from its obligations. Otherwise, the seller can only be protected by an indemnity of purchaser if the seller is held liable after closing.
- Employment relationships pertaining to the sold (part of the) business transfer to purchaser by operation of law, if the business constitutes an undertaking (*Betrieb*) or part thereof. Employees are entitled to object to the transfer with the effect that they remain employed by the seller, and a termination of their employment by the seller is only possible within the statutory limitations. If the business does not constitute an undertaking or part thereof, the individual employment relationships must be transferred with the consent of the respective individual employees. This is usually done by way of three-party agreements between the old employer, the new employer and the employee.

2.3.2 Allocation of liabilities

The liabilities of the sold business can generally be freely allocated between the seller and the purchaser. German law does not provide for a general successor liability. Important exemptions apply to:

(a) employment liabilities vis-à-vis employees transferring to the purchaser by operation of law (see above);
(b) certain pre-closing tax liabilities; and
(c) liabilities in general if the purchaser continues to use the seller's trade name. However, the transfer of such liabilities may be excluded if certain requirements are met.

2.3.3 Formal requirements

Subject to the exemptions below, a sale and transfer by way of an asset deal does not require a specific form. For reasons of evidence, transactions of such kind are usually entered into in writing.

Notarisation of the purchase agreement is required if (1) the sold assets include any real property, (2) the sold assets include any shares in German limited liability companies or foreign entities comparable to German limited liability companies, or (3) the seller undertakes to sell and transfer substantially the entire business as a whole (ie, the sold assets and contracts are not defined by way of exhaustive schedules).

2.4 Carve-out transactions

A carve-out is required if the sold business is not already conducted by a separate legal entity. The seller may decide to conduct the carve-out prior to or in parallel with the transaction.

In the case of a carve-out prior to the transaction, the seller first separates the sold business into one or more dedicated entities by way of group internal asset deals or contributions, spin-offs or hive-downs. The transaction objects are then the shares in such entity or entities.

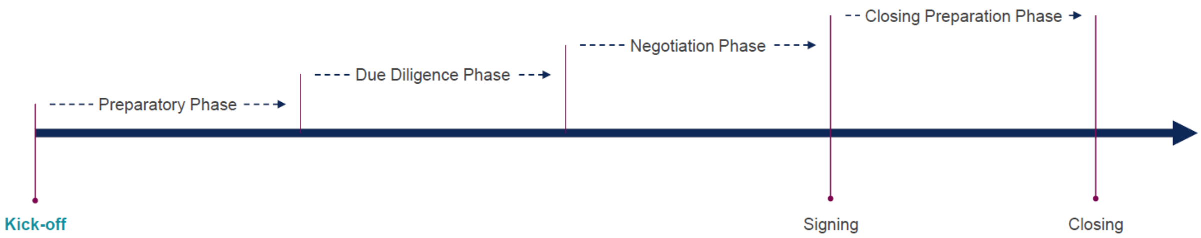
A carve-out in parallel with the transaction can be conducted in two ways:

(a) by separating the business into one or more dedicated entities between signing and closing. In such cases, the transaction objects are the shares in such entity/entities; or
(b) via an asset deal with the purchaser in which only the assets, contracts and liabilities of the target business are sold and transferred to the purchaser.

2.5 Tax considerations

As a matter of principle, a seller will typically prefer a share deal over an asset deal since capital gains resulting from the sale of shares are partly exempt from corporate income tax (plus a solidarity surcharge) and trade tax (95 per cent exemption if the seller is a corporation or a partnership consisting of corporate partners, or 40 per cent exemption if the seller is an individual or a partnership consisting of individual partners). In contrast, a purchaser will typically prefer an asset deal over a share deal in order to take advantage of depreciation of the business assets (there is no regular depreciation of shares).

3. M&A PROCESS



3.1 Preparatory phase

Before potential investors are approached, the seller should determine the fundamentals of the transaction, ie:

- the exact scope of the target;
- the transaction structure (share deal or asset deal);
- any carve-out requirements;
- whether there is to be a (limited) auction process or one-to-one negotiations.

The further process depends on whether the transaction is run as an auction or as one-to-one negotiations.

3.2 Process in case of one-to-one negotiations

(a) negotiation of pre-agreements (non-disclosure agreement (NDA); term sheet);
(b) process as agreed between the parties in a term sheet or otherwise;
(c) due diligence;
(d) negotiation of final transaction documentation;
(e) signing; and
(f) closing.

3.3 Auction process

(a) sharing of a teaser with potential interested parties;
(b) NDAs with parties that have indicated interest in the acquisition based on the teaser;
(c) standardised process based on process letters provided by the seller's M&A adviser;
(d) sharing of information memorandum with remaining interested parties;
(e) indicative offers based on information memorandum;
(f) due diligence (often supported by a legal factbook prepared by the seller's legal advisers) for bidders that have been admitted to the due diligence based on their indicative offers;
(g) in parallel, provision of seller drafts of the purchase agreement and other transaction documents to bidders (eg, via the data room);
(h) confirmatory offers from bidders, including a mark-up of the purchase agreement;
(i) negotiations with bidders that have been selected based on the confirmatory offers;
(j) selection of the successful bidder by the seller;
(k) signing; and
(l) closing.

3.4 Warranty and indemnity insurance

Warranty and indemnity (W&I) insurance has become a common feature in the German M&A market. A large part of medium-sized and large transactions are now (fully) W&I insured. The concept for the implementation of W&I insurance in the current German M&A market is as follows:

- the seller makes fundamental and business-related representations and warranties in the purchase agreement;
- the purchaser takes out W&I insurance covering all representations and warranties

and, in many cases, claims under the tax indemnity; and

- direct claims of the purchaser against the seller are either excluded (zero liability concept) or limited to a low threshold. The zero liability concept has become more common in recent years.

Meanwhile, insurance providers (for a higher insurance premium) also offer W&I insurance products that are not linked to seller declarations (synthetic W&I insurance).

In auction processes, W&I insurance is often introduced as a requirement for all bidders and is prepared by the seller together with an insurance broker (stapled W&I insurance). Non-binding indications from the insurance providers are presented to the bidders, usually in the data room. Towards the end of the process, the remaining bidders are invited to complete negotiations with the insurance providers.

4. PRE-AGREEMENTS

The following types of pre-agreements are seen in most M&A transactions in Germany:

(a) confidentiality agreement (NDA);
(b) clean team NDA; and
(c) term sheet/memorandum of understanding (MOU)/letter of intent (LOI) (not in auction processes).

Other pre-agreements may be required under certain circumstances, such as a co-sale agreement in the case of more than one seller, which defines the cornerstones of a transaction in which all sellers are prepared to divest.

4.1 NDAs

Non-disclosure agreements are entered into between the seller and interested parties early in the transaction process in order to ensure that information exchanged with respect to the target and the transaction is kept confidential.

4.2 Clean team NDAs

Where competitively sensitive information is to be disclosed as part of the transaction process, in particular to strategic investors, stronger protection is required. To achieve this goal, clean team NDAs are entered into. The seller may extend the protection of a clean team NDA to commercially sensitive information. A clean team NDA usually contains the following additional rules:

- disclosure only in a separate part of the virtual data room (usually read-only) or even a physical data room;
- access only by a limited number of advisers or purchaser representatives not involved in the same business area (clean team);
- rules for reports on the sensitive information, eg, presentation of aggregated information only, or a requirement to present the prepared reports to the seller’s counsel for approval prior to disclosure.

4.3 Term sheets/MOUs/LOIs

In transactions with only one potential purchaser, the parties may enter into a preliminary agreement on key terms before engaging on discussions on the long-form documentation. Such agreements are often referred to as a term sheet, MOU or LOI.

The preliminary agreements are usually non-binding since they are entered into at an early stage of the transaction. Sellers frequently insist on the signing of a preliminary agreement as a prerequisite for opening the data room. In the unlikely event of a binding preliminary agreement, the agreement may require notarisation. This is the case if the long-form agreement for which the preliminary agreement provides the basis must be notarised (see above).

Key contents of the preliminary agreement are:

- description of the transaction;
- key commercial and legal terms; and
- timeline and intended process, eg, regarding due diligence and the preparation of the long form agreements.

The preliminary agreement may also contain rules regarding exclusivity, break fee or cost cover.

5. DUE DILIGENCE

5.1 Purpose of due diligence

From a purchaser perspective, the purpose of the due diligence is to (1) confirm the information provided by the seller in initial discussions, a teaser or an information memorandum, (2) identify potential issues, and (3) prepare the decision whether to acquire the business and on what terms.

The due diligence is seller's key disclosure tool. Disclosure in the data room:

- typically excludes seller's liability for warranty breaches under the purchase agreement (see below); and
- allows the seller to fulfil its statutory disclosure obligations and to mitigate liability risks resulting from a breach of such obligations.

5.2 Data room

The due diligence information is usually provided in a virtual data room maintained by a professional data room provider. The selection of a suitable data room provider is important for the seller to be able to document the content of the data room as of signing.

Physical data rooms are generally no longer used in M&A transactions in Germany. Exemptions may apply to data rooms for highly sensitive information, eg, for the service agreements of top management disclosed to the purchaser shortly before signing.

5.3 Scope/report

Legal due diligence covers the areas of law that the purchaser considers relevant to the business. Typically, relevant fields of law are discussed between the purchaser and its legal advisers prior to the start of due diligence.

The scope and style of the due diligence report needs to be discussed between the purchaser and its advisers. While detailed and comprehensive due diligence reports were standard in German M&A practice in the past, nowadays most clients prefer issue-focused red flag reports – ie, reports that highlight only those issues that may be relevant for the transaction instead of providing detailed descriptions of the content of the documents available in the data room.

If W&I insurance is to be entered into, special requirements need to be taken into consideration:

- W&I insurance requires a thorough purchaser due diligence in all areas to be covered by the W&I insurance;
- the due diligence must be based on materiality thresholds that concur with the *de minimis* and basket thresholds agreed with the insurance provider; and
- the due diligence report must contain precise risk descriptions and evaluations.

5.4 Vendor due diligence report/legal fact book

The seller may support bidders' due diligence by conducting vendor due diligence and providing a vendor due diligence report or a legal fact book. A vendor due diligence report with reliance for the bidders is extremely rare in German M&A practice. It may be useful in highly competitive and fast processes to accelerate the due diligence.

In by far the most cases, the seller provides a legal fact book prepared by its counsel based on a limited vendor due diligence. The aim of the legal fact book is to give bidders an initial insight into the legal affairs of the business and the proposed transaction. The legal fact book contains a description of relevant facts, but no risk assessment. It is not intended to replace the due diligence by the bidders themselves. The legal fact book is typically provided on a non-reliance basis.

6. SHARE/ASSET PURCHASE AGREEMENT

Share and asset transfer agreements are generally in line with international standards, in particular in case of medium-sized and large transactions. However, there are certain variations due to applicable German law. Agreements that are subject to German law are often shorter and less wordy compared to agreements subject to US or UK law.

6.1 Rules on sale and transfer

The rules on the sale and transfer of the purchase object are different for a share deal and an asset deal.

6.1.1 Share deal

In a share deal, the rules relating to the sale and transfer are straightforward. The rules mainly comprise the identification of the sold shares and usually a condition for the transfer of the shares (usually payment of the purchase price or performance of the closing actions).

6.1.2 Asset deal

The sale and transfer rules in an asset purchase agreement are more complex. The purchase agreement will typically include the following:

- A detailed description of the sold assets, contracts, receivables and liabilities, either in the form of exhaustive schedules or a generic description (eg, 'predominantly pertaining to the business' or 'exclusively pertaining to the business'). Even where there is a generic description, schedules listing the relevant tangible and intangible assets and contracts as of signing are generally attached to the agreement.
- Rules on how the of claims and liabilities under sold contracts are allocated between the seller and the purchaser, eg, delineation as of closing or transfer of all claims and liabilities.
- Rules on the process for obtaining required third-party consents to the transfer of contracts and liabilities and fall-back rules if consent cannot be obtained.

6.2 Purchase price

The consideration for the objects of the transaction is typically a purchase price paid in cash. However, consideration may also be provided in other forms, such as shares in the acquiring entity. The following sections focus on a cash consideration.

There are two main purchase price concepts: a fixed purchase price agreed as of signing (locked box) or a variable purchase price subject to adjustment as of closing (closing accounts).

6.2.1 Locked box

In the case of a locked-box concept, the parties agree on the enterprise value and the equity value at signing based on existing financial statements of the target (eg, as of the end of the last fiscal year or (audited) interim accounts of the target prepared for the transaction). In practice, the relevant financial statements should not have a reference date older than six months prior to signing.

There is no subsequent adjustment of the purchase price as of closing based on the actual volume of cash, debt and working capital.

Changes to the financial situation of the target between the effective date and closing are, therefore, to the benefit or detriment of the purchaser. The purchaser is only protected against outflows of cash or other value to the seller or related parties by a no-leakage covenant, ie, a provision that any of such outflows must be refunded to the target, and by certain ordinary course of business warranties and covenants.

6.2.2 Closing accounts

In the case of closing accounts, the parties agree on the enterprise value at signing. The equity value will be adjusted as of closing based on the actual volume of cash, financial debt and working capital. The cash, financial debt and working capital are determined on the basis of financial accounts drawn up as of the closing date. If the parties cannot agree on the volume of the cash, financial debt and working capital positions, a neutral expert decides with binding effect for the parties.

Changes to the financial situation of the target between signing and closing are, therefore, to the benefit or detriment of the seller.

6.3 Special purchase price-related concepts

6.3.1 Earn-out

Where there is uncertainty or disagreement between the seller and the purchaser about the future development of the company, the parties may agree on an earn-out to bridge the valuation gap. In this event, payment of part of the purchase price will depend on certain targets being achieved (eg, based on EBITDA and turnover).

From a seller perspective, it is important to choose financial parameters that can be clearly determined and to agree on adjustments that neutralise extraordinary events or any 'financial engineering' by the purchaser.

6.3.2 Vendor loan

If the purchaser is unable or unwilling to fully finance the transaction, the seller may grant a vendor loan. However, limitations set by German banking laws (licensing requirements) must be obeyed. A vendor loan is, therefore, usually structured as a deferral of the purchase price. Restrictions also apply to later changes to the loan terms (such as increases of interest or prolongations), as these may trigger licensing requirements as well.

6.3.3 Escrow/hold back

In order to secure claims of the purchaser under the purchase agreement, eg, under seller warranties, the purchaser may retain a part of the purchase price for a certain period of time (hold back) or pay part of the purchase price into an escrow account which is usually held by a notary. Payment into an escrow account is more common. Should the purchaser subsequently have valid claims, a respective amount can be ultimately retained by the purchaser or paid to the purchaser from the escrow account. Any funds remaining after expiry of the applicable limitation periods are paid to the seller.

6.4 Pre-closing obligations

6.4.1 General obligations

Share and asset purchase agreements usually contain covenants for the seller and the target company with respect to the conduct of the business. Under such covenants, the seller and the target company are obliged to conduct the business in the ordinary course of business, and to obtain the prior consent of the purchaser for certain material measures stipulated in the purchase agreement.

If regulatory filings (in particular, relating to merger control or foreign investment control rules) are required, the purchase agreement also contains rules on the parties' obligations in connection therewith. In particular, the purchase agreement sets out the extent to which the purchaser must propose or accept remedies requested by the relevant authorities.

6.4.2 Additional obligations in carve-out transactions

In the case of a carve-out transaction, the purchase agreement will contain additional obligations, *inter alia*, rules on:

- the physical separation and the IT separation and respective responsibilities of the parties;
- the termination of intra-group financing and the release of seller from potential guarantees granted to the target entities, including compensation claims if the seller is held liable under such guarantees post-closing; and
- the termination of domination agreements or profit and loss transfer agreements (ie agreements enabling group-wide control and/or group-wide pooling of profits and losses), including protection of the seller against post-closing claims arising from such agreements.

6.5 Reverse indemnity

In share deal transactions, the seller will insist on protection against legacy liabilities from the past, in particular against claims asserted by the target company against the seller that arise from the seller's former shareholding in the target company. The purchase agreement will typically oblige the purchaser to indemnify the seller against such claims. The aim of such a reverse indemnity is to avoid windfall profits of the purchaser from claims made by the target company that have not been reflected in the purchase price.

6.6 Closing

6.6.1 Closing conditions

The number and scope of closing conditions depends on the negotiating power of the parties.

From a seller perspective, closing conditions can be detrimental to transaction certainty. The seller will, therefore, try to limit the closing conditions to conditions legally required to consummate the transaction – eg, obtaining the required regulatory approvals. The seller may also offer certain 'controllable' closing conditions, such as the performance of certain clearly defined carve-out measures.

From a purchaser perspective, additional closing conditions are helpful to ensure that the business transfers in a condition that is in line with the purchaser's expectations. Closing conditions proposed by purchasers typically include obtaining approvals from third parties, the transfer of a certain number of employees, the absence of a material adverse effect and the 'day one readiness' of the carve-out business. However, it is difficult for the purchaser to succeed with such proposals in the current market, in particular in an auction process.

6.6.2 Closing actions (all measures required in connection with the transfer of the shares/business)

The closing actions consist of all actions that are required to perform the contemplated transaction, eg, (1) payment of the purchase price, (2) transfer of the sold shares or the sold business (ie, the sold assets, contracts, receivables and liabilities), (3) adoption of the required shareholder resolutions, and (4) conclusion of ancillary agreements.

6.6.3 Closing memorandum

After all closing actions have been performed, the parties usually execute a closing memorandum confirming that all closing conditions have been fulfilled or waived, all closing actions have been performed or waived and that closing has occurred. In some transactions, the execution of the closing memorandum is a condition precedent for the transfer of the shares or the business.

6.7 Representations and warranties

Representations and warranties protect the purchaser against unknown risks relating to the business. Known risks are covered by specific indemnities, since seller liability for breaches of representations and warranties is typically excluded if the purchaser knew about the breach at signing (see below). Representations and warranties are made as a promise of guarantee: ie, the seller is liable for breaches of representations and warranties regardless of whether it is at fault or not. The scope of the representations and warranties depends on the type of transaction, the negotiating power of the parties and whether W&I insurance is in place.

The purchase agreements usually contain certain title warranties and certain business-related warranties, eg regarding financial statements, material assets, material agreements, IP, IT hardware and compliance with (material) laws. Sellers typically try to limit representations and to include knowledge qualifiers and materiality thresholds as far as possible. Depending on the purchaser’s negotiating power, additional warranties may be added.

Generally speaking, warranty catalogues in German M&A transactions are less extensive and more specifically worded compared to US-style catalogues. Where W&I insurance is in place, the seller may offer more representations and warranties than in transactions with direct seller liability. Sellers typically aim at restricting representations and warranties to statements that can be reasonably evaluated by them or the target business, in order to avoid potential statutory liability for making warranty statements without having sufficiently reviewed the underlying facts. In distressed M&A transactions, representations and warranties, if they are offered at all, are typically limited to title.

6.8 Remedies

6.8.1 Exclusive liability regime

German law contains provisions dealing with defects of purchased objects. However, the legal consequences of these provisions are not suitable for M&A transactions, since they may lead, *inter alia*, to an unwinding of the transaction post-closing. It is, therefore, customary for share and asset purchase agreements to provide for an exclusive liability regime. The mandatory liability for intent and fraud is not affected and may occur, in particular, where there is an intentional violation of disclosure obligations or where untrue statements have intentionally been made.

6.8.2 Losses

German purchase agreements rarely cover all of the purchaser’s losses which would be awarded under the German Civil Code. The parties instead negotiate the scope of the losses to be compensated by the seller.

The parties usually agree on the general concept that, as a first step, the seller must take remedial action to restore the situation that would exist had there not been a breach of representations and warranties (restitution in kind). If restitution in kind is not possible, or is not effected within a certain time period, the seller must pay monetary compensation to the purchaser. The exact scope of losses to be compensated is a matter for negotiation between the parties. In most cases, the scope of losses to be compensated will be within the following framework (at least in medium-sized and large transactions):

- Direct damages are to be compensated by the seller.
- Compensation for indirect and consequential damages forms the main point of negotiations, in particular compensation for lost profits or losses resulting from business interruptions. A typical compromise is that indirect and consequential damages that are reasonably foreseeable are to be compensated. Alternatively, purchase agreements may refer to indirect and consequential damages covered by the purpose of the relevant representation and warranty.
- The following forms of damage are typically excluded: reductions in the value of the purchase object, internal costs and expenses, reputational damages and damages calculated based on valuation methods applied by the purchaser (eg, multipliers).
- No punitive damages (punitive damages are not awarded under German law).

6.8.3 Exclusion of liability

German share and asset purchase agreements generally contain the standard exclusions also seen in an international context (eg, recovery from a third party, contributory fault of the purchaser and reflection in the financial statements). The details are subject to discussion between the parties.

Unlike in many US-style transactions, claims of the purchaser from breaches of representations and warranties are typically excluded if the purchaser knew of the circumstances leading to the breach (sandbagging). In this context, the content of the data room is often deemed known to the purchaser. Depending on the outcome of the negotiations between the parties, attribution of knowledge may be limited to information that has been ‘fairly disclosed’ in the data room. The standard for fair disclosure is typically defined in the purchase agreement.

6.8.4 Limitation of liability

Finally, the purchase agreement contains customary rules on a limitation of liability.

De minimis *and baskets*
The *de minimis* amount is usually between 0.1 per cent and 0.2 per cent of the purchase price, and the basket is between 1 per cent and 2 per cent of the purchase price. Whether the *de minimis* and basket are tipping or deductible is subject to negotiations between the parties.

Cap
The cap largely depends on the negotiating power of the respective parties and the size of the transaction. It usually ranges between 10 per cent and 50 per cent, although caps outside this corridor are occasionally seen. The cap for fundamental warranties is often at the purchase price. Claims based on leakage or tax indemnities are frequently capped at the purchase price or not capped at all.

Time limitation
The typical time limitation for claims based on breaches of representations and warranties ranges between 12 and 24 months, and sometimes up to 36 months. Fundamental warranties usually become time-barred after expiry of three to ten years. Taxes and special indemnities (eg environmental indemnity) are subject to special time limitations.

6.9 Tax indemnity

Share purchase agreements typically contain a tax indemnity to delineate tax liabilities and tax benefits as of the effective date (locked-box date or closing date). In the case of an asset deal, the seller usually accepts an indemnity with regard to the purchaser's statutory secondary liability for certain pre-closing tax liabilities of the sold business.

6.10 Special indemnities

Special indemnities are agreed to protect the purchaser against known risks with regard to which the level of exposure is not (yet) known or in dispute between the parties. The most important special indemnity is the environmental indemnity. Environmental indemnities often place obligations on the purchaser not to perform certain activities that may increase the seller's exposure (no dig/no drill). Risk sharing via a sliding scale, pursuant to which seller's liability for environmental damages decreases over time, is also customary.

6.11 Post-closing obligations

The purchase agreement also contains certain rules regarding the post-closing relationship between the parties. Typical post-closing obligations include the confidentiality obligations of both parties, and the obligations of the purchaser to preserve documents relating to the business for the statutory retention periods. Depending on the specific transaction and the negotiating power of the parties, additional obligations may be agreed upon, including:

- an obligation on the seller not to compete with the sold business for a certain time period after closing and/or not to solicit employees of the sold business; or
- an obligation on the purchaser and the target company not to use trade designations of the seller after closing (in particular in the case of carve-out transactions).

6.12 Miscellaneous provisions

The miscellaneous provisions contain general rules for the purchase agreement. Such rules include a prohibition on assigning claims (although assignments to affiliates or financing parties are sometimes allowed) and a provision as to which party must bear the costs of the transaction such as notarisation fees and filing fees. In most cases, the purchaser bears such costs in German M&A transactions.

The miscellaneous provisions also set out whether potential disputes are to be settled in court or via arbitration. Both methods are common in German M&A transactions.

Arbitration proceedings are often chosen for medium-sized and large transactions. Advantages include the fact that arbitration proceedings are confidential, can be conducted in English (although some German courts now offer court proceedings in the English language as well) and are potentially quicker. Conversely, court proceedings are often the cheaper option and are generally more accessible for smaller claims.

7. ANCILLARY AGREEMENTS

The seller and the target company may also enter into ancillary agreements for the period after closing. Ancillary agreements are particularly important in the case of carve-out transactions where the target company cannot be operated on a fully standalone basis immediately after closing, eg, because IT separation cannot be completed prior to closing. The most common ancillary agreements are transitional (IT) service agreements. Further ancillary agreements include lease agreements, supply agreements or long-term service agreements.