A new dawn for Dutch buy-outs

Six months on, it's time to see how the market is dealing with the repeal of a prohibition on financial assistance for Dutch BVs

On October 1 2012, the financial assistance prohibition for BVs (private companies with limited liability) was repealed. Private equity and leverage finance practitioners welcomed the repeal because the prohibition has been a source of much uncertainty since its introduction. This uncertainty was due in part to the limited guidance provided by case law of the Netherlands Supreme Court on the various issues of interpretation that arose.

The bank's perspective

The financial assistance prohibition has been repealed in its entirety; it has not been replaced by a new prohibition. This means that under the new regime, a target BV is free, vis-à-vis third parties, to provide financial assistance, such as . granting guarantees, security and loans, for the financing of the acquisition of its shares, subject only to the usual restrictions such as *ultra vires* and voidable preferences.

In practice, banks have started to take advantage of this greater flexibility – sometimes somewhat hesitantly and uneasily – by requiring full guarantees and security from target companies. Nevertheless, some banks continue to insist on a debtpush-down, ie structuring the acquisition loans at the level of the operating companies as much as possible. It seems that this is no longer necessary since operating companies can fully guarantee these loans and a debtpush-down does not improve the bank's position. If the guarantee can be invalidated on the basis of any of the legal limitations referred to above, a loan will likely share a similar fate (assuming similar circumstances).

> **The prohibition has been a source of much uncertainty since its introduction**

The new regime also has consequences for existing deals. Firstly, the new regime implies that improperly structured deals are no longer null and void as long as the nullity was not invoked prior to October 1 2012. Another consequence is that guarantees and security that are limited by the operation of so-called limitation wording in credit documentation have most likely become unlimited by operation of law. Whether this is indeed the case depends on how the particular limitation wording has been drafted and the law applicable to such credit documentation. Secondly, banks can now require guarantees and security from a target BV for existing acquisition debt that up to now has been unsecured, for example because it was completely excluded from the guarantees and security due to financial assistance concerns.

The board's perspective

So far, the managing boards of BVs do not seem terribly concerned with the treatment of financial assistance under the new rules. In our view, this lack of concern is justified. According to the parliamentary history of the new legislation, the provision of financial assistance must be considered on a par with all other commercial transactions a BV can enter into. There is no presumption of liability (no so-called *prima facie* liability) if a BV's managing board cooperates in the provision of financial assistance. The managing board must consider carefully whether the provision of financial assistance is in the BV's corporate interest and what consequences it will have for the BV's financial position. In that respect, the managing board should in any event consider the following questions:

(1) is the company a suitable LBO candidate and, in particular, does it have predictable and sustainable cash flows?;

(2) will the company be capable of meeting its financial obligations in the foreseeable future, i.e. in the next 12 months?;

(3) have sufficient precautions been taken to deal with risks that have been identified?; and

(4) have the interests of all stakeholders been carefully weighed?

It is unlikely that liability will arise where the managing board has duly considered the above questions and – based on reasonable financial and other assumptions – has answered them affirmatively, even if in retrospect one or more of the answers to these questions proves to be incorrect.

> **Some banks continue to insist on a debt push-down**

Director liability arises only in exceptional circumstances. The parliamentary history emphasises that a court is not allowed to 'step into the shoes of the entrepreneur' and that there is a so-called grey zone in which the managing board should be given the benefit of the doubt. Furthermore, a mistake or miscalculation – even if it adversely affects the company and/or its creditors – does not automatically constitute a ground for directors' liability. According to the parliamentary history such mistakes or miscalculations include an incorrect assessment of economic factors, the conscious taking of certain risks and a failure to take sufficient precautions against economic setbacks.

We have not yet seen boards or sponsors arguing that the new regime should have a downward effect on the margins demanded by banks given their improved guarantee and security position. Perhaps because it seems unlikely that banks will be receptive to such an argument since in acquisition financings cash flows, and controlling cash flows, are generally more important than the value of the collateral.

But uncertainty remains

The articles of association of many BVs contain provisions referring to or incorporating the substance of the former financial assistance prohibition. Not because there was a legal requirement to do so, but mainly to have the articles of association contain a complete overview of all relevant rules and regulations applicable to the company, whether mandatory or not.

There has been discussion in the legal community as to whether this would limit such a BV's ability to provide financial assistance after all. In our view, the provisions in question should in most cases simply be considered as unwritten; an amendment to the BVs articles of association – although in itself a fairly simple exercise – is usually not required. This because the applicable transitional rule provides that if the articles of association refer to a statutory provision that was in effect before October 1 2012 or if they incorporate the substance of such a provision, the articles will be deemed to refer to or incorporate that provision as in effect after October 1 2012. We interpret this to mean that if the relevant statutory provision has been repealed (as in the case of the financial assistance prohibition), the relevant provision(s) in the articles can be disregarded.

> **"Banks can now require guarantees and security from a target BV for existing acquisition debt**

The only exception to the above transitional rule is that it does not apply if the result would not be in line with the purpose of the clause in question. The majority view seems to be that this exception may only be relevant if the company has multiple shareholders and the clause prohibiting the company from providing financial assistance was included in the BV's articles of association to protect the minority shareholders. Another, probably rather academic, example is where it is apparent that the clause was intended to survive the repeal of the financial assistance prohibition. In any event the effects of such a clause can only be internal, ie result in liability of the BV's managing board. It cannot have external effect, ie limit the BV's ability to provide financial assistance to third parties.

More good news

The repeal of the financial assistance prohibition was part of a major overhaul of the rules governing BVs, giving them more flexibility than before. The new so-called flex BV legislation sets the stage for a possible increase in the number of recaps and similar liquidity events, as the new rules generally impose fewer formal hurdles for company distributions.

In short, so long as the BV will continue to be able to pay its due and payable debts (and there are no reserves that must be maintained by law or under the articles) a distribution can be made even when it will result in negative equity. However, at the same time, the responsibilities and liability risks for managing directors when making such distributions have become more explicit and are expected to result in new dynamics between company boards and private equity investors.

NautaDutilh's report, 2013 The Netherlands private equity and leveraged finance market – an outlook, is available at

http://www.nautadutilh.com/highlight_attachments/n_US_NautaDutilh_Private_Equity_and_Leveraged_Finance.pdf

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