Going double Dutch

The Netherlands is one of Europe's most creditor-friendly jurisdictions. It's now vying with Luxembourg as the holding company jurisdiction of choice

For a number of years now, many large and mid-sized European leveraged buyout (LBO) financings have been structured using a double Luxembourg holding company structure (double Luxco). More recently, double Dutchco structures – in which the holding companies, whether intermediate or otherwise, are Dutch – have also appeared in European LBOs. These have featured when it is preferable, for example from a tax planning perspective, to locate the holding company in the Netherlands. The sponsor's acquisition structure will include a Dutch holding company (Dutchco 1) that holds 100% of the shares in a second Dutch holding company (Dutchco 2). Dutchco 2, or a wholly owned subsidiary, then obtains acquisition financing and purchases the target company and its group. The most common legal form for Dutch holding companies is a *besloten vennootschap met beperkte aansprakelijkheid*, or BV. This is a private limited liability company under Dutch law.

The European Commission's December 2012 proposals to amend Council Regulation (EC) No 1346/2000 on insolvency proceedings (EIR), specifically article 2(g), further bolster double Dutchco (and Luxco) structures. This is because the amendments specify the *situs* of registered shares in a company, as a result of which a pledge over shares in a Dutch BV will be immune from the negative effects of any unfavourable foreign insolvency proceedings. This amendment is part of the package approved by the European Parliament on February 5 2014.

Why go double?

The main reason to set up a double Dutchco or Luxco is to facilitate an easy enforcement sale of the target group by the secured lenders, or to neutralise the unfavourable effects of another EU member state's insolvency regime. A good example of this is French safeguard proceedings (*procédure de sauvegarde*), which can impose a stay on or hamper enforcement of secured lenders' security rights. Double Dutchcos and Luxcos help prevent this by enabling secured lenders to take control of the target group by exercising voting rights at the holding companies, target and target group levels. This prevents the borrower group from applying for insolvency proceedings that would protect the target group against enforcement by the secured lender.

Implementing a double Dutchco or Luxco structure obviously weakens the bargaining position of the sponsor and target group in any restructuring negotiations.

Dutch share pledge enforcement

Secured creditors have a strong position under Dutch insolvency law. Indeed, the Netherlands is among the most secured creditor-friendly jurisdictions in Europe. Insolvency proceedings in the Netherlands tend to occur in only two situations: the disorderly wind down of a business; or a carefully planned pre-packed restructuring that requires a bankruptcy to significantly downsize its workforce or terminate onerous lease contracts. There is no statutory obligation for a company's directors to file for insolvency under any circumstances. And there are few situations (other than those mentioned above) in which there is an incentive for them to do so.

More importantly, the commencement of insolvency proceedings makes no difference to secured creditors – they are almost entirely free to proceed with enforcement after such a filing. Insolvency proceedings in the Netherlands protect the interests of creditors, both secured and unsecured, and do not protect the debtor. As a consequence, neither has an incentive to open such proceedings.

Dutch insolvency proceedings do not affect the validity of the security or pledgee's enforcement rights. The only proviso is that it is possible for a court to impose a cooling off period (or moratorium) of up to four months. An order to this effect could, however, be challenged under certain circumstances, and specific court permission for enforcement despite the moratorium can be sought. The pledgee can enforce its rights without having applied for insolvency proceedings.

The enforcement of a Dutch share pledge is a relatively easy, quick and predictable exercise. The most common enforcement method is an out-of-court private sale by the pledgee to a third party with the pledgor's approval. To be valid, the pledgor's approval must be given only after a payment default occurs regarding the secured obligations. However, if the pledgor does not want to cooperate, the pledgee can request the court to authorise its private sale of the pledged asset, either to a third party for the agreed price or to the pledgee itself for a price determined by the court. This price would be based on valuation evidence presented to the court by the pledgee. Pledgees sometimes opt for this route to mitigate any perceived liability risks. This was the case in the much publicised Schoeller Arca matter of 2009.

> **"Proposals to amend the EIR further bolster double Dutchco structures**

The pledgee can initiate the process if a payment default is continuing. Whether or not there is a payment default should, in our view, be determined under the law applicable to the credit agreement. Before submitting a petition to the court to authorise the private sale, the pledgee will select a potential purchaser (which can be the pledgee itself, for example, by way of a credit bid) and will agree a draft share purchase agreement with that purchaser. Market testing is not required under Dutch law. But it is advisable to consider some kind of analysis of potential interest from third parties, to get some comfort on the company's market value. Also, a hostile party may garner some sympathy from the court if the pledgee cannot present evidence that it looked for the best price available in the market. In our view, however, whether or not other potential purchasers (including competitors of the target group) were asked to make a bid should not be a decisive factor in the court's assessment of whether to authorise the sale.

A court hearing usually takes place within two to three weeks after the date of the petition. Discussions during the hearing will focus on whether the price offered for the shares is optimal and fair, and the court is free to weigh the evidence presented. The pledgee may use all available means to justify the price offered, although it is customary to have one or more valuation reports drawn up by reputable experts. However, credible offers that have actually been made by potential alternative buyers can be expected to carry more weight than a valuation report. The court will invite and hear from all interested parties (including the pledgor and other creditors), but out-of-the-money creditors are not likely to be called. An alternative bidder will not be recognised as an interested party, but will be heard by the court as part of its investigation into whether the price for which the pledgee is seeking court approval is fair. The court is likely to reject the petition if, during the proceedings, another party makes an unconditional offer that is higher than that agreed by the pledgee and purchaser, and the court considers the offer to be a credible one. The court does not have the power to order a sale to the third party instead of the prospective purchaser selected by the pledgee. The court will be particularly cautious if the pledgee asks permission to sell to a party that is affiliated with the ultimate shareholder(s) or a senior lender, and if the only interests that stand to be impaired by the enforcement sale are those of the mezzanine or junior lenders.

A judgment can be expected within two to three weeks after the hearing. But delays may occur if the court deems it necessary to call interested parties in other jurisdictions, or if valid objections (supported by valuations, competitive bids or other evidence) are raised against the price. In these situations it is difficult to predict when a judgment can be expected, but it is likely to take another two to three weeks. The Dutch Code of Civil Procedure does not provide a right of appeal against the ruling. However, on the basis of the case law of the European Court of Human Rights, appeal is nevertheless allowed in exceptional circumstances and on limited grounds. Those grounds are that the court has exceeded the scope of the statutory provision or that fundamental principles of due process have been violated. An appeal on the merits of the judgment is not possible. The prevailing view is that when an appeal is possible, it should be lodged within three months.

Transfer of voting rights

The creation of a pledge over registered shares in a Dutch BV may also include a transfer of the attached voting rights from the pledgor to the pledgee, which requires a resolution of the company's shareholders. The transfer of voting rights can be prohibited under the company's articles of association, but it is fairly easy to amend this to lift any prohibition. The deed of pledge usually provides that voting rights will only transfer to the pledgee upon the occurrence of an event of default and notification of that event to the pledgor and the company. We believe that other voting-rights trigger events can be agreed upon in the deed of pledge. This could include: the commencement of certain insolvency proceedings affecting the company or its subsidiaries; any action that could result in the loss by the company of the right to appoint or dismiss board members of a subsidiary; any merger involving a subsidiary; or the taking of any action that would result in amendments to the articles of association (or similar documents) of a subsidiary.

A pledgee with voting rights cannot participate in the adoption of any resolutions without a formal general meeting of shareholders. Unless expressly permitted by the articles of association, a pledgee with voting rights cannot convene a general meeting of shareholders. It is therefore advisable to amend the articles to give such pledgees this power, if necessary.

> "Enforcing a Dutch share pledge is relatively quick, easy and predictable

Insolvency proceedings in other member states

A sponsor or borrower could gain leverage over its secured lenders by threatening to make Dutchco 1 and 2 subject to unfavourable insolvency proceedings in another EU member state. This could be a jurisdiction where, for example, the insolvency regime provides for a lengthy stay on enforcement. For these companies to be subject to such proceedings, it would be necessary for a court in that other member state to rule that the centre of main interests (Comi), within the meaning of the EIR, of Dutchco 1 or Dutchco 2 is located in that member state.

But even if the sponsor or borrower is successful in arguing that the relevant Comi must be deemed to be located in that other member state, article 5 of EIR provides that opening insolvency proceedings in that other jurisdiction will not affect Dutchco 1's pledge over the shares in Dutchco 2 if those shares are 'situated within the territory of another Member State at the time of the opening of proceedings'. The preamble to the EIR describes the rationale for the rule set out in article 5 as follows:

'There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since these are of considerable importance for the granting of credit. The basis, validity and extent of such a right in rem should therefore normally be determined according to the lex situs and not be affected by the opening of insolvency proceedings. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security.'

Based on the EIR in its existing form, it is not entirely clear how article 5 ought to be interpreted with regard to the location of shares in a Dutch BV. These are always in registered form and have no physical documents evidencing their existence. Under Dutch law a share is not considered a claim, but a right (asset) of a distinct nature. Article 2(g) of EIR currently specifies where three types of assets are situated, but does not seem to apply to BV shares as they do not fit any of the three categories mentioned. The amendments to article 2 of EIR proposed by the European Commission and now adopted by the European Parliament create another category. New article 2(h) will provide that 'the Member State in which assets are situated shall mean, in the case of (iii) registered shares in companies, the Member State within the territory of which the company having issued the shares has its registered office'.

This amendment, which conforms with the prevailing views of authoritative legal writers, basically shields the pledgee of shares in a BV from the effects of any unfavourable insolvency proceedings in another EU member state. Although the European legislative process for the amendment of the EIR has not yet been completed, this development is good news for secured creditors lending to a double Dutchco and, more generally, further improves the very strong position of secured creditors in the Netherlands.

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