

THE ACQUISITION
AND LEVERAGED
FINANCE
REVIEW

FIFTH EDITION

Editor
Marc Hanrahan

THE LAWREVIEWS

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CONTENTS

PREFACE.....	v
<i>Marc Hanrahan</i>	
Chapter 1 INTRODUCTION	1
<i>Marc Hanrahan</i>	
Chapter 2 ARGENTINA.....	8
<i>Tomás Allende</i>	
Chapter 3 AUSTRALIA.....	20
<i>John Schembri and David Kirkland</i>	
Chapter 4 AUSTRIA.....	34
<i>Markus Fellner, Florian Kranebitter and Paul Luiki</i>	
Chapter 5 BRAZIL.....	42
<i>Fernando R de Almeida Prado and Fernando M Del Nero Gomes</i>	
Chapter 6 CANADA.....	60
<i>Jean E Anderson, David Nadler, Carrie B E Smit, David Wiseman, Caroline Descours and Chris Payne</i>	
Chapter 7 CHINA.....	77
<i>Xiong Yin, Jie Chai and Qin Ma</i>	
Chapter 8 DENMARK.....	85
<i>Nikolaj Jubl Hansen, Soren Theilgaard and Caspar Rose</i>	
Chapter 9 GERMANY.....	98
<i>Thomas Ingenhoven and Odilo Wallner</i>	
Chapter 10 HUNGARY.....	113
<i>Melinda Pelikán, Zsófia Polyák and János Pásztor</i>	

Contents

Chapter 11	INDIA	124
	<i>Justin Bharucha</i>	
Chapter 12	IRELAND	134
	<i>Catherine Duffy and Robbie O'Driscoll</i>	
Chapter 13	JAPAN	145
	<i>Satoshi Inoue, Yuki Kohmaru and Risa Fukuda</i>	
Chapter 14	LUXEMBOURG	154
	<i>Laurence Jacques and Thomas Bedos</i>	
Chapter 15	NETHERLANDS	167
	<i>Sandy van der Schaaf and Martijn B Koot</i>	
Chapter 16	PORTUGAL	176
	<i>Gonçalo Veiga de Macedo and Teresa Novo Faria</i>	
Chapter 17	SWEDEN	185
	<i>Paula Röttorp and Carolina Wahlby</i>	
Chapter 18	SWITZERLAND	195
	<i>Lukas Wyss and Maurus Winzap</i>	
Chapter 19	TURKEY	208
	<i>Umut Kolcuoğlu, Bihter Bozbay and İpek Yüksel</i>	
Chapter 20	UNITED KINGDOM	219
	<i>Neil Caddy, Russell Jacobs, Mark Stamp, Mitali Ganguly and Francesca Mosely</i>	
Chapter 21	UNITED STATES	229
	<i>Lauren Hanrahan, Eschi Rahimi-Laridjani, Douglas Landy, Morgan Lingar, James Kong and Archan Hazra</i>	
Appendix 1	ABOUT THE AUTHORS	239
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS	255

PREFACE

In the early 1980s, leveraged loans and high-yield bonds began to be used to finance leveraged buyouts (LBOs) and other acquisition transactions. Those were simpler times. Back then, leveraged finance was principally a US phenomenon. The annual aggregate amount of leveraged loans and bonds issued in a year was a few tens of billions. Some of today's top-tier private equity shops were just getting started, and were certainly not household names. The documentation and relevant legal issues, while significant, were a fraction of those that are involved in leveraged finance today.

My, how things have changed. While loans and bonds are still a standard feature of the leveraged finance product menu, they have taken on different shapes and flavours, and additional financing products have been developed and are now widely used. The number of participants in leveraged finance has grown massively, and a large number of the players are now based in Europe and Asia. In addition to banks and institutional investors, direct lenders have now joined the party. Standard documentation for most types of leveraged finance has at least doubled in size. The amount of leveraged loans issued in 2017 for M&A exceeded US\$300 billion in the US alone,¹ with the LBO M&A subset posting the second-highest year ever of issuances at US\$126 billion (a 44 per cent increase compared to 2016).²

While there have been ups and downs, of course, for leveraged finance over the past 40 years (most notably during the financial crisis), leveraged finance used to support acquisitions has become a very big business and is almost certainly here to stay (and probably grow).

This volume is intended to contribute to the knowledge base of lawyers who participate, or aspire to participate, in leveraged finance used for acquisitions. It will hopefully provide an overview and introduction for the novice and be a ready resource for an active practitioner who needs to know about relevant laws and practices in jurisdictions around the world.

Thanks to my partners Casey Fleck and Doug Landy, and my associate Gabi Paolini, for their help in editing the volume and preparing the Introduction that follows.

Marc Hanrahan

Milbank Tweed Hadley & McCloy LLP
New York, NY
November 2018

1 *2017 U.S. Primary Loan Market Review*, LSTA Loan Market Chronicle 2018, p. 20.

2 *What's Market: 2017 Year-End Trends in Large Cap and Middle Market Loan Terms*, Practical Law Finance, 1 February 2018.

NETHERLANDS

Sandy van der Schaaf and Martijn B Koot¹

I OVERVIEW

Although the total value of M&A transactions dropped significantly in 2017 compared to the previous year, the number of M&A transactions in the Netherlands increased in the last year and was the highest in a decade. Owing to economic growth and improved bank liquidity in the Netherlands, the acquisition and leveraged finance market in the Netherlands experienced an increase in activity as well.

The vast majority of the acquisition and leveraged finance transactions in the Netherlands is financed by attracting loans from Dutch and larger European banks. Small facilities (up to €30 million) are usually funded by a single bank, whereas midsize facilities (between €30 million and €250 million) and large facilities (in excess of €250 million) are usually funded by a syndicate of banks. In the case of small acquisition loans, banks typically use their own standard templates, but especially in the case of larger loans, the loan documentation that is used is often based on the Loan Market Association (LMA) templates.

Other forms of acquisition financing, such as debt capital markets (DCM) financing, US private placement debt and equity financing, are increasing in the Netherlands but are still less frequently used compared to bank financing.

II REGULATORY AND TAX MATTERS

i Regulatory matters

Since 1 January 2007, the Act on Financial Supervision (Wft) regulates the financial sector in the Netherlands and contains detailed rules on the supervision of the main financial market parties, being banks and insurers, investment firms, collective investment schemes (i.e., investment companies and unit trusts) and financial service providers.

Under the Wft, it is prohibited for a credit institution to attract repayable funds from the public. The definitions of ‘credit institution’, ‘repayable funds’ and ‘public’ are concepts of European law.² In the absence of European guidance, ‘public’ under the Wft means anyone other than professional market parties or parties forming part of a restricted circle. If a party attracts repayable funds with a minimum amount of €100,000 (or its equivalent in another currency) per drawing, the lender is considered to be a professional market party. This means that as long as the amount of the initial loan granted by each lender (including any assignee

¹ Sandy van der Schaaf is a senior associate and Martijn B Koot is a partner at Heussen.

² European Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

or transferee) to a Dutch borrower is at least €100,000 (or its equivalent in another currency) the borrowings by the Dutch borrower are allowed. It is common practice to include wording in the facility agreement stipulating that a loan to a Dutch borrower shall at all times be provided, assigned or transferred to or otherwise assumed by a lender that does not form part of the public.

ii Money laundering and sanctions

On 1 August 2008, the Money Laundering and Terrorist Financing (Prevention) Act (Wwft) entered into force implementing the European directive on prevention of the use of the financial system for the purpose of money laundering and terrorist financing (the Third Anti-Money Laundering Directive). On 25 July 2018, the Fourth Anti-Money Laundering Directive was implemented into Dutch law by way of an amendment of the Wwft.

The Wwft applies to banks and other financial undertakings as well as to certain persons or legal entities, such as life insurance companies, investment firms, trust companies, external accountants and tax advisers, lawyers and notaries, casinos and companies that distribute credit cards.

The objective of the Wwft is to prevent and combat money laundering and the financing of terrorism in order to guarantee the integrity of the Dutch financial system. The Wwft imposes two main obligations on relevant institutions or persons: (1) performing customer due diligence; and (2) reporting unusual transactions. As part of the rules on customer due diligence, the Wwft requires a financial undertaking to conduct a risk analysis both prior to entering into a relationship with a customer and on an ongoing basis.

Sanction regulations are rules instituted in reaction to breaches of international law or human rights violations. Pursuant to Dutch sanction regulations, a financial undertaking may be required to freeze funds and assets of particular persons or organisations, or be restricted in providing funds or services to such persons or organisations. Sanction regulations require financial institutions to adapt their administrative organisation and internal controls in order to meet the requirements under the applicable sanction regulations.

Fines may be imposed on the offender under the anti-money laundering or sanction regulations. In addition, failure to comply with certain requirements under the anti-money laundering and anti-terrorist financing regulations or the sanction regulations constitutes a criminal offence under the Dutch Economic Offences Act.

iii Tax issues

The Netherlands does not levy any withholding taxes with regard to any payments of principal or interest by a borrower under a loan agreement (except for subordinated loans with a maturity in excess of 50 years and profit-linked interest). The Netherlands also does not levy any stamp duties. In principle, interest payments on acquisition debt made by a Dutch borrower are deductible subject to various statutory restrictions.

III SECURITY AND GUARANTEES

i Types of security rights and guarantees in the Netherlands

In Dutch acquisition financing transactions, the security package depends on the risk profile and the assets of the relevant debtor. Under Dutch law, the concept of a floating charge does

not exist. For each type of asset, a specific security right can be vested to secure present and future monetary payment obligations. However, it is possible to combine various rights of pledge in one omnibus pledge agreement.

There are two types of security rights that can be created over assets: a right of pledge and a right of mortgage. A right of pledge can be established over movable assets (e.g., inventory, equipment, stock and commodities), receivables (e.g., trade receivables, intercompany receivables, bank account receivables and insurance receivables), registered shares and intellectual property rights. A right of mortgage can be established over registered property (i.e., real estate, registered vessels and aircraft).

A Dutch law security right can only be established over assets which are sufficiently identifiable and transferable or assignable. A security assignment (i.e., transfer of legal title to assets for security purposes) is not allowed under Dutch law.

Right of pledge over movable assets

A right of pledge over movable assets can be created as a non-possessory right of pledge or a possessory right of pledge. A right of pledge over (all present and future) movable assets is established by means of a written pledge agreement entered into between the pledgor and the pledgee and, in case of a non-possessory right of pledge, registration thereof with the Dutch tax authorities, unless the pledge agreement is executed in the form of a notarial deed. In the case of a possessory right of pledge over movable assets (which is not commonly used in acquisition financings), the pledgee or a third party appointed by the pledgor and the pledgee and acting on behalf of the pledgee must have effective and exclusive control over the movable assets and the control may not be held together with the pledgor.

Right of pledge over receivables

A right of pledge over receivables can either be disclosed or undisclosed. A disclosed right of pledge requires a written pledge agreement between the pledgor and the pledgee and notice of the right of pledge to the relevant debtors and is usually established with respect to intercompany receivables, insurance receivables and bank account receivables. In the case of a right of pledge over bank account receivables, the pledgee usually authorises the pledgor to continue to dispose of the monies held in bank accounts until the occurrence of a certain event (e.g., an event of default). Pursuant to the general banking terms and conditions, Dutch bank accounts are usually encumbered with a first right of pledge held by the account bank. This first priority right of pledge may be waived by the account bank or limited to fees and costs.

An undisclosed right of pledge over receivables is established by means of a written pledge agreement between the pledgor and the pledgee which is registered with the Dutch tax authorities. Registration of the pledge agreement with the Dutch tax authorities is not required if the pledge agreement is executed in the form of a notarial deed. For commercial reasons, a right of pledge over trade receivables is generally not notified to the debtors and is, therefore, created as an undisclosed right of pledge over receivables, but notification of the trade debtors is necessary to invoke the right of pledge. In the case of 'absolute future receivables' (i.e., receivables that do not already exist at the time of creation of the right of pledge and that do not directly result from a legal relationship existing at the time of creation of the right of pledge), supplemental pledge agreements need to be entered into. An undisclosed pledge must be registered with the Dutch tax authorities on a regular basis in order to effectively establish a right of pledge over such receivables.

Right of pledge over shares

A right of pledge over registered shares in the capital of a Dutch private company with limited liability (BV) or a Dutch public company with limited liability (NV) is established by means of a deed of pledge of shares executed before a Dutch civil law notary. Owing to the fact that a pledgee can only enforce his or her rights as a pledgee against the company in whose capital the shares are pledged if the company has been notified of the right of pledge, the company is usually a party to the notarial deed. It is common practice to include in the deed of pledge of shares that the voting rights attached to the shares remain with the pledgor until the occurrence of a certain event (e.g., an event of default) upon which the voting rights will transfer to the pledgee. Depending on the articles of association of the company whose shares are being pledged, the conditional transfer of voting rights requires the prior approval of the general meeting of the company. The right of pledge must be registered in the shareholders' register of the company, but this registration is not a constitutive requirement.

The establishment of a right of pledge over other types of shares or equity interests (such as bearer shares, membership interests in a cooperative or partnership interests in a limited or general partnership) is not discussed in this chapter.

Right of pledge over intellectual property rights

A right of pledge over intellectual property rights is established by means of a written pledge agreement between the pledgor and the pledgee or by means of a deed of pledge executed before a Dutch civil law notary. In general, each written pledge agreement concerning IP rights or related rights, or both, should be registered with the Dutch tax authorities for evidence purposes, and in relation to licences and domain names, this registration is necessary to create a valid right of pledge. In addition, the pledge agreement (or notarial deed, as the case may be) should be registered with the relevant IP register or .nl internet domain name registrar, or both, (if applicable). Each register or registrar has its own requirements for registration.

Right of mortgage over registered property

A right of mortgage can be established over real estate, registered vessels and aircraft registered in the Netherlands and is established by means of a notarial deed of mortgage executed before a Dutch civil law notary and registration of the right of mortgage in the relevant register.

Guarantees and other forms of security

Corporate guarantees and declarations of joint and several liability by the parent company or its (key) subsidiaries, or both, are common in group financings and are commonly included in the facility agreement. Guarantee limitations as to the maximum amount of the guarantee are uncommon in the Netherlands.

ii Limitations on the granting of security rights and guarantees

Ultra vires/corporate benefit

Under Dutch law, granting upstream, downstream and cross-stream guarantees or security is allowed, provided that: (1) this falls within the scope of the corporate objects clause of the company; and (2) there is sufficient corporate benefit for the company. Any legal act entered into by a Dutch company may be nullified by the company or the bankruptcy trustee in the event of bankruptcy if it is *ultra vires* (i.e., falls outside the scope of the company's objects). A legal act may be *ultra vires* if: (1) the legal act is not expressly allowed by the objects clause

in the company's articles of association and could not be conducive to the realisation of these objects; and (2) the other party was aware thereof or should be aware thereof without an independent investigation. All relevant circumstances of the case should be considered. There is no clear definition of corporate benefit, but it generally means that the contemplated transaction should be in the interest of the company and its stakeholders, whereby in the case of group financings the interest of the group of companies may prevail over the interest of the individual company and its stakeholders.

Corporate authorisation and capacity

In the case of a right of pledge over shares in a Dutch company, it should be checked whether the articles of association of the company allow the establishment of a right of pledge over its shares and the transfer of the voting rights attached to the shares. In addition, the articles of association may contain share transfer restrictions. Further, depending on the articles of association, a right of pledge of shares may require a shareholders' resolution of the company approving the (conditional) transfer of the voting rights attached to the shares.

Works council

A Dutch company with 50 or more employees is required to have a works council. If a works council is in place, the prior advice of the works council needs to be obtained for certain important decisions relating to the transactions listed in the Dutch Works Council Act (such as a change of control over the company, borrowing under material loans and the granting of security for material loans, unless the granting of security takes places in the ordinary course of business).

Financial assistance

Under Dutch law, a public company with limited liability (NV) may not provide collateral, guarantee the price, otherwise guarantee or otherwise bind itself jointly and severally if this is done for the purpose of the subscription or acquisition by third parties of shares in the NV's own capital. In addition, an NV may not grant loans for the purpose of the subscription or acquisition by third parties of shares in the NV's own capital, unless the management board of the NV decides to do so after having received the prior approval of the general meeting of the NV and the following conditions are met with regard to the NV: (1) the loan, including the interest received by the company and the security provided to the company, is provided at fair market conditions; (2) the equity, less the amount of the loan, is not less than the paid-up and called-up part of the capital, plus the reserves that must be maintained in accordance with the law or the articles of association; (3) the creditworthiness of the third party or, in the case of multiparty transactions, of each party involved, has been carefully investigated; and (4) if the loan is granted with a view to the subscription to shares in the context of an increase of the company's issued capital or with a view to acquiring shares held by the company in its own capital, the price at which the shares are subscribed to or acquired is fair.

The financial assistance prohibition also applies to all Dutch or foreign subsidiaries of an NV, including Dutch BVs. Security rights, guarantees and loans granted in breach of this prohibition are regarded as being null and void.

Upon the entry into force of the Act on the simplification and flexibilisation of the rules applicable to Dutch BVs on 1 October 2012, the financial assistance prohibition

prohibiting a BV from providing assistance to a third party by way of providing security and restricting the granting of loans for the purpose of acquiring shares in the BV's issued capital, was abolished.

Actio pauliana

A legal act (such as the granting of guarantees or security rights) performed by a Dutch person (or legal entity) can be nullified upon the initiative of any creditor if each of the following requirements are met:

- a* the person performing the legal act had no legal obligation to do so;
- b* the person performing the legal act and the other party or parties knew or should have known that the legal act would adversely affect the recourse possibilities of present and future creditors; and
- c* the legal act was prejudicial to the recourse possibilities of the creditors of the person performing the legal act.

This action, generally referred to as *actio pauliana*, is also possible when the company has been declared bankrupt, in which case it will be initiated by the bankruptcy trustee.

Security agent

The general view in the Netherlands is that a right of pledge can only be created in favour of a pledgee if the pledgee itself (and not as representative or trustee of the lenders) is the creditor of the claim for which the right of pledge is created. For this reason, if security is to be held by a security agent, for the purpose of establishing Dutch law security a 'parallel debt' is created whereby each obligor undertakes as an additional and separate obligation to pay to the security agent (in its own name and not as the representative of the lenders) amounts that are equal to the amounts of the loan obligations owed under the loan documents. Subsequently, a Dutch law security right is created in the name of the security agent only (and not also in the name of the other loan parties) as security for the payment of the parallel debt. The security agent will distribute the proceeds resulting from an enforcement of the security right in accordance with the contractual arrangement agreed upon between the loan parties.

iii Enforcement of security rights

Under Dutch law, if the debtor is in default with the performance of the secured obligations, a right of mortgage can be enforced by way of a public auction or a private sale authorised by the competent Dutch court. A Dutch law right of pledge can be enforced by way of a public auction, a private sale authorised by the competent Dutch court or a private sale agreed between the pledgor and the pledgee after the pledgee has become entitled to enforce the right of pledge. A disclosed right of pledge over receivables is usually enforced by collection of the receivables after the relevant debtors have been given a notice of enforcement. The same applies with regard to the enforcement of an undisclosed right of pledge provided that the relevant debtors are first notified of the right of pledge. A right of pledge over receivables can also be enforced by way of a public auction, a private sale or a court-ordered private sale. The mortgagee or the pledgee may apply the proceeds from the enforcement towards satisfaction of the secured obligations as they are due and payable.

IV PRIORITY OF CLAIMS

As a general rule, claims of creditors rank *pari passu*, both in and outside bankruptcy of the debtor, unless Dutch law provides otherwise. Ordinary claims are subordinated to claims with a preferred ranking, such as claims of secured creditors and creditors that have a preference (both over ordinary claims and claims of secured creditors) by virtue of law (such as rights of retention and privileges of the Dutch tax authority and bankruptcy trustees). In the event of bankruptcy of a debtor, all unsecured and unsubordinated creditors are entitled equally to the proceeds of the insolvent debtor's assets *pro rata* to the amount of their claims.

In the Netherlands, there is no public register in which rights of pledge are registered, and therefore it cannot be verified from publicly available information whether specific assets are encumbered with a right of pledge. Rights of mortgage are registered in the registers maintained by the cadastre.

Under Dutch law, a security right can be a first-, second-, etc., priority ranking security right, whereby the highest priority is given to the security right that was created first in time. In the event of a debtor's bankruptcy, a secured creditor can in principle enforce his or her security right as if there was no bankruptcy. However, the court can order a cooling-off period during which the secured creditor may not enforce the security right. The proceeds resulting from the enforcement of a security right are used to repay the claim secured by the first-ranking security right, and any access amount will be used to repay any claim secured by a second-ranking right of pledge (if applicable).

Parties can also agree that the claims of one party are subordinated to the claims of the other party. This is commonly addressed in intercreditor agreements. Pursuant to Dutch case law, the enforceability of a contractual subordination arrangement depends not only on the wording of such arrangement as the meaning that each of the parties in the given circumstances could reasonably have attributed to the relevant provisions and what they could reasonably expect from each other is, in principle, decisive.

If a company has been declared bankrupt, claims for repayment of equity are subordinated to all other claims on the bankruptcy estate. Since from a Dutch legal perspective shareholder loans do not qualify as equity, claims of shareholders resulting from shareholder loans rank *pari passu* with all other claims on the bankrupt estate.

V JURISDICTION

i Choice of law

In general, the parties to an agreement are free to choose the governing law of the agreement. The choice of a foreign law as the law governing an agreement will generally be recognised and applied by the courts of the Netherlands, provided that it does not conflict with mandatory rules of Dutch law or public order.

ii Submission to jurisdiction

The submission by a Dutch entity to the jurisdiction of foreign courts is valid under Dutch law, subject to the limitations following from the EC Jurisdiction Regulation³ and does not preclude that claims for provisional measures in summary proceedings and requests to levy pretrial attachments are brought before the competent courts of the Netherlands.

iii Enforcement of court decision or arbitral award

If an enforcement treaty applies, a final and enforceable judgment rendered by a foreign court against a Dutch entity with respect to its obligations under an agreement governed by foreign law will be recognised by the Dutch courts and could be enforced in the Netherlands, subject to the provisions of the relevant treaty and the rules and regulations promulgated pursuant thereto.

If no enforcement treaty applies, a judgment rendered by a foreign court would not automatically be enforceable in the Netherlands. However, under current practice, a final judgment obtained in a foreign court that is not subject to appeal and is enforceable in the foreign country in which it is rendered would generally be upheld by a Dutch court without substantive re-examination or relitigation on the merits of the subject matter of the foreign judgment provided that certain formal and substantive requirements are met.

The enforcement in the Netherlands of a foreign judgment must be performed in accordance with Dutch laws of civil procedure.

A final award issued by an arbitration panel in a foreign country that is enforceable in the foreign country with respect to the obligations of a Dutch entity under an agreement governed by foreign law will be recognised by a Dutch court without re-examination of the merits of the case and will also be enforceable in the Netherlands.

VI ACQUISITIONS OF PUBLIC COMPANIES

The statutory framework for acquisition of listed companies in the Netherlands consists primarily of the Wft (see Section II.i) and the Public Bid Decree, which provides detailed procedural rules on public bids.

Listed public companies in the Netherlands are subject to the supervision by the Dutch Authority for Financial Markets (AFM). Companies having their registered seat in the Netherlands, but whose shares are listed on a regulated market elsewhere in the European Union, are also subject to supervision by the AFM.

In general, pursuant to the Wft, if a person or institution wishes to make an offer to purchase securities that are listed on a regulated market in the Netherlands, it needs to publish an offer document, which requires the approval by the AFM. In addition, evidence of 'certain funds' must be provided. The evidence of certain funds needs to include a detailed description of the manner in which the funds necessary to pay the offer price will be provided. In practice, the certain funds requirement is often met by way of a commitment letter setting out the main terms of the funding followed by the actual finance documentation once the offer has been published.

3 Council Regulation No. 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, amended by Council Regulation No. 542/2014 of 15 May 2014.

A shareholder holding at least 95 per cent of the shares in the capital of a Dutch public listed company can squeeze out the minority shareholders. There are two kinds of squeeze-out procedures, both of which must be initiated before the Enterprise Chamber of the Amsterdam Court of Appeal: (1) a regular squeeze-out procedure; and (2) a special squeeze-out procedure that can only be followed if the majority shareholder has made a public bid. A regular squeeze-out procedure can be initiated at any time and will usually take six to 12 months. Shares that have special voting or other rights attached (such as priority shares) cannot be the subject of a regular squeeze-out procedure. In principle, the court will honour a request for a regular squeeze-out but it must deny the request if certain special circumstances apply. A special squeeze-out procedure is only available for a shareholder having made a public bid and holding not only 95 per cent or more of the issued share capital but also 95 per cent or more of the voting rights attached to the shares of the target company. A special squeeze-out procedure can apply to all kinds of shares, including priority shares. It must be initiated within three months of the completion of the public bid. In the event of a special squeeze-out procedure, whereby the offer price is assumed to be a fair price for the shares subject to the squeeze-out provided that certain requirements are met, the procedure will usually take less time to complete than a regular squeeze-out procedure.

If a party acquires more than 30 per cent of the voting rights attached to the shares in the capital of a company having its registered seat in the Netherlands and whose shares are listed on a regulated market elsewhere in the EU, it is obliged to make a public offer to purchase the remaining shares in the capital of the company. The certain funds requirement does not apply in relation to such a mandatory offer.

VII OUTLOOK

As the economy in the Netherlands continues to perform well and the Netherlands is still an attractive jurisdiction for foreign investors, M&A activity is expected to remain stable or even increase in the coming year. Owing to the historically low interest rates, acquisition and leveraged financing is easy and cheap for acquirors to obtain. There is, however, a high level of unpredictability as to how the M&A market will develop in the near future, which is because of developments in international politics and relations and in national politics with international consequences – Brexit, international sanctions, new trade tariffs being imposed, the renegotiation of existing international trade agreements and the US tax reform may all affect the economy and the M&A market in the Netherlands in the coming years.

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Sandy is a senior associate in the banking and finance practice. She has a particular emphasis on domestic and cross-border finance transactions, structured finance, securitisation and restructuring. Sandy heads HEUSSEN's German Desk and has both Dutch and the German nationality. Furthermore, she is also qualified as a Rechtsanwältin, and is a member of the German-Dutch Lawyers Association (DNRV) and the German-Dutch Business Association (DNG).

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