

NETHERLANDS

Dutch bankruptcy law pitfalls in M&A transactions

BY MUAZZIN MEHRBAN



With troubled sellers looking for the best price, buyers on the hunt for potential bargains and creditors hoping for swift and full reimbursement, the Netherlands' bankruptcy law has come under greater scrutiny due to its impact on distressed deals. Many parties are unaware of the potential risks that can arise in M&A transactions under the country's insolvency regime. One of the major sticking points of Dutch bankruptcy law concerning M&A is the ability of a bankruptcy trustee to nullify certain transactions based on fraudulent conveyance. Trustees usually scrutinise any transactions that occurred prior to bankruptcy to verify whether they unlawfully affected creditors. In a worst-case scenario, nullification could see the purchaser end up empty-handed.

However, in practice, trustees are more likely to ask for some sort of compensation, rather than try to unwind a transaction, which can have undesirable consequences not just for the parties involved but also for the wider economy. "Buyers need to be aware that if, between signing and closing, a petition is filed for the debtor's insolvency, the closing of the transaction can be at jeopardy," notes Matthieu Tak, a partner at Grant Thornton. "Dutch bankruptcy law provides that payments made by the debtor, even if there is a legal obligation to pay, while the receiver of the payment knew that a bankruptcy petition was pending, can be subjected to avoidance actions. It is very likely that the

closing of an M&A deal will be treated similar to a payment made by the debtor." He adds that problems can arise even if an arms-length price was paid prior to the bankruptcy for the assets of the bankrupt entity. Although the burden of proving fraudulent behaviour rests with the administrator, in certain cases it can be reversed so that the knowledge of prejudice is presumed to exist and, as a result, becomes the buyer's obligation to prove otherwise. Voided transactions often result in the buyer making a proportionate or non-preferential claim on the insolvent debtor.

Mitigating risks

The most common form of fraudulent conveyance is the undervaluation of a transaction, whereby a seller realises a lower sale price, leaving creditors with a shortfall in bankruptcy proceeds. But as with any transaction, it can never be absolutely certain that the price agreed by both parties for an asset reflects its true value, especially if the vendor is experiencing financial difficulty. "There are various ways to mitigate the risk of a transaction being nullified by the trustee on this basis," says Hendrik van Druten, a partner at Loyens & Loeff N.V. "First of all, one should seek independent confirmation that the price agreed reflects the market value of the relevant asset, such as a valuation report from an independent and reputed valuator." Not only is

an independent valuation a good idea, but, in many circumstances, it is considered a statutory requirement. Furthermore, it can act as an insurance policy against tax assessment and accuracy-related penalties. Hence, it is of paramount importance that the party performing the valuation is not only wholly independent, but also qualified for such a process.

In addition, an arrangement can be agreed in the short term, whereby should a trustee establish that the price paid is too low, the purchase can be completed at a recommended value. "However, even in this instance, a valuation report will be necessary, as it will give the purchaser comfort that it is not actually signing a blank cheque. Also, it will make it harder for the trustee to prove that the initial price offered was not impartial, but only if there is already a valuation report on the table confirming that it was," explains Mr Van Druten. One way of bypassing a liquidator challenge is to ensure that, when selling assets which are subject to a security right, the proceeds from the sale go directly from the purchaser to the owner of the right, which upon receipt of that payment release its security right. Liquidators will then most likely be unable to challenge the transaction as it will not be classed as detrimental to creditors since, in the event of a traditional bankruptcy, ordinary unsecured creditors would not receive any money unless, the value of the assets exceeds the claim of the creditor secured.

Experts suggest that the most straightforward method of avoiding such problems is for purchasers to acquire outright the target's shares, in conjunction with its bank debts and associated security rights. In this instance, should the company's restructuring fail post-acquisition, at the very least the acquirer has control over the assets and the investment has a degree of protection. Often, banks acting as creditors will be prepared to sell their secured claims at a discounted rate to save themselves the hassle of enforcing security rights. In return, banks, through selling the claim rather than enforcing their creditor rights, have immediate certainty as to the amount they will recover, which would otherwise be unclear. However, even a certified valuation analyst will not necessarily be qualified to perform the valuation unless he ►►

or she regularly engaged in similar types of valuations.

Often treated as just a formality, obtaining the right advice is crucial to conducting a distressed transaction in an efficient and cost-effective manner. Voidance under Dutch law depends on many factual circumstances, making it paramount that a documented paper trail is present. Buyers should formulate a procedure that will minimise the chances of creditors becoming prejudiced towards a transaction. In certain distressed deals, where the final outcome is not certain, it is sometimes advisable to pay the purchase price into escrow. Escrow itself is charged at a rate that is commensurate with the costs of producing the service, the liability undertaken, and the overhead expenses, which include a profit factor. As a result, fees can vary from transaction to transaction, although typically a minimum fee is established.

But an agreed-upon escrow may not prevent a trustee from attempting to nullify a transaction based on an existing contractual obligation, which is possible if the transaction is deemed to have prejudiced a creditor. There must also be evidence that the transaction was the result of conspiracy between the transacting parties, which has led to the deal favouring the buyer over the asset's creditors. Voidance can also occur if the buyer entered into a deal knowing that a request to declare bankruptcy had already been filed by the owner of the assets. In the majority of cases, however, it can be difficult to prove these circumstances, especially if the buyer has demonstrated that it took adequate precautions during the deal process.

Indeed, having the consideration paid by the buyer and confirmed by a valuator will make it almost impossible for the trustee to prove that the purchaser knew that the transaction would prejudice creditors. "The main clawback rule only applies for transactions that are not based on a contractual or other legal obligation. Hence, if the obligation to enter into the transaction was made earlier, the transaction cannot be voided by an insolvency administrator" asserts Christiaan Zijderveld, a partner at Simmons & Simmons. "An administrator can only claim voidance if the earlier obligation is successfully voided, the transaction was agreed while a petition for bankruptcy was pending or by suggesting the transaction is the result of a conspiracy to defraud creditors, the latter being near impossible to prove by an administrator" he argues. To further protect themselves, purchasers dealing with a seller in financial

distress should determine that the vendor has a strong chance of survival and that bankruptcy proceedings are unlikely. Although one cannot always predict whether a vendor will go bankrupt in the future, the responsibility of providing evidence that the deal was above board may shift to the purchaser, especially if the transaction is at under-value.

Impact on creditors

Even with these preventative measures, Dutch financial law, in general, tends to favour creditors. Individual secured creditors in particular cannot be forced to accept a restructuring as they might be in other countries. Indeed, if there is a syndicate of secured creditors, the consent of all parties must be gained before any form of restructuring activity can take place. "Full consent is not always necessary in other jurisdictions. Sometimes you have a system where you have either a majority or a super-majority vote," explains Johan Jol, owner of Legal Houdini. "This basically means you can force some of the secured creditors, if they are a minority, to accept the fact that a restructuring will take place. In the Netherlands, however, this is not the case." As an alternative, distressed companies could in some cases use their securities mechanism to conduct an out-of-court restructuring, gaining permission from a court to sell pledged shares before refinancing into a new entity. "This structure enables secured creditors to be forced out, and even though it has not been tested against senior secured creditors but only in a recent case against junior secured creditors, it may be possible to do this contrary to the wishes of the minority senior creditors whereby, through a majority of senior creditor votes, they will be obliged to accept a deal," adds Mr Jol. This could be an interesting mechanism for leveraged deals, as the process can effectively bypass the rigours of a bankruptcy process.

Just over two years ago, the Dutch government was considering a new insolvency law. But discussions about its implementation have since died down. There was talk of legislation aimed at curbing the power of individual secured creditors, so obliging them to accept situations in which a majority of secured creditors could push through an agreement. Naturally, banks acting as lenders openly opposed the move, which would significantly reduce their individual power in the event of a bankruptcy. "Currently, one of the possibilities creditors have under the Dutch bankruptcy act is requesting the

supervisory judge to have the trustee take or refrain from certain actions, such as the sale of assets to a certain buyer," says Teun Struycken, a partner at NautaDutilh. "In that case, the creditor will need to demonstrate to the supervisory judge that its interests are being compromised by the proposed action or lack of action by the trustee," he adds. However, once a company has been declared bankrupt, creditors in principle are no longer allowed to take recourse on the assets of the company. However, during bankruptcy and suspension of payments, secured creditors can take recourse on assets of the debtor, provided that a moratorium, which can last up to four months, has not been applied. "In short, creditors in the Netherlands do have the ability to invoke rights against a purchaser or the administrator," explains Mr Tak. "Sometimes this may be an uphill battle, but if the purchaser and the debtor did not take the right steps in the process leading up to the transaction – like, for instance, obtaining proper valuations – chances are that the parties to the transaction are subject to legal action by creditors."

Netherlands-based companies engage in a relatively high number of cross-border transactions, considering the size of the country. In cases of multi-jurisdictional distressed M&A, the laws governing fraudulent conveyance vary from location to location and therefore must be cross-referenced. "On the basis of the EC insolvency regulation, it is important to check where the centre of main interest (COMI) of the vendor lies," says Mr Van Druten. "If post-completion of the transaction the vendor goes bankrupt, one cannot always rely on the bankruptcy law of the country of origin of the vendor to apply. Should the COMI of the vendor be in another EC jurisdiction, then the bankruptcy laws of that other jurisdiction will apply as well as other rules regarding fraudulent conveyance." In addition, how well the process is managed, particularly in cross-border deals, is often dependant on the quality of professionals hired.

The Netherlands is currently experiencing a high volume of bankruptcy cases, stretching the resources of personnel available to deal with them. "There is definitely a shortage of what can be described as experienced liquidators," notes Mr Jol. "And of course, when sacrifices are made in terms of quality, it can make the whole process more difficult. When there is a lack of experience

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at ground level, issues that can later prove problematic are often overlooked. Furthermore, poorly-conducted court bankruptcies could make banks more reluctant to provide fresh capital against new securities because the Supreme Court could rule the deal to be a fraudulent treatment of creditors," Mr Jol adds. He envisages that, for the foreseeable

future at least, this will be an issue for the Netherlands to resolve.

Any reluctance of banks to provide financing for distressed deals could drag out the bankruptcy process, as both buyers and sellers are left without the necessary capital to either complete acquisitions or fund their restructurings. But experts predict that more

deals will be completed through an execution process, whereby sellers ask the court for permission to sell assets without challenge from liquidators. To negate the execution process, dealmakers must ensure that the unsold part of the company survives for more than a year, in what is known in most jurisdictions as a hardening period. ■



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Matthieu started his career at Rabobank International as an International Cash Management Consultant before becoming a corporate relations manager at Rabobank Amsterdam, focusing on large enterprises. Hereafter, Matthieu continued his career at Lloyds TSB Bank where he was responsible for Leverage Finance for internationally operating Dutch companies. Here, he first got in touch with distressed assets and

special credit. After a few years, he moved to London where he became responsible for the European Distressed Assets within the International Banking division of Lloyds TSB. Hereafter, Alvarez & Marsal recruited Matthieu to become a senior director at their Turnaround & Restructuring department. Here, the emphasis was on hands-on financial and operational restructuring of companies in distress. Recently, Matthieu

decided to make the transfer to Grant Thornton where he is now practice leader of the Restructuring & Performance Improvement unit in the Netherlands. Matthieu has vast sector experience in the food, automotive, beverages, information technology, manufacturing and construction industry across Europe and the Middle East. Matthieu Tak is fluent in English, German and Dutch.