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Dutch PE regains its edge

Nathalie van Woerkom and Carlos Pita Cao of AKD Prinsen Van Wijmen outline Dutch efforts to be more fund-friendly

The private equity and venture capital industry continued to secure its position during 2006 in the corporate world of the Netherlands. After the industry's success in 2005, figures relating to 2006 again showed a substantial increase in the total value of private equity deals.

But from a public relations perspective, the private equity industry in the Netherlands was on the defensive during the year. As in other countries, media and political discussions flared up over private equity funds and hedge funds and culminated in the former Minister of Economic Affairs characterizing the funds as "locusts" devouring and stripping "our" companies.

The hostile treatment of the private equity industry by the Dutch media, some politicians and trade unions was largely due to the attitude of a number of hedge funds as activist shareholders in Dutch listed companies including Ahold, Stork and recently ABN Amro Bank. Specifically, it revolved around attempts to induce the managements of these firms to pursue a strategy of selling off sections of their operations, to focus exclusively on their respective core businesses. Moreover, as elsewhere in Europe, concerns were raised about the level of debt that private equity acquisitions generally bestow on target companies.

For the time being, calls to tighten regulation of the industry appear to have dissipated. The issues raised have, however, influenced the overall sentiment towards shareholder power and control with the result that the scales have been tipped in favour of ensuring the interests of all stakeholders in a company, including employees. One example of this is the obstruction of proposals to amend existing legislation to limit or even prohibit the managements of listed companies from taking defensive anti-takeover measures through the introduction of a breakthrough rule (*doorbraakregeling*).

Recent developments

After a stirring and eventful 2006, developments in the first months of 2007 suggest that it promises to be another interesting year for the private equity and venture capital industry in the Netherlands. The sums managed by private equity funds continue to grow and, as most investments are highly leveraged, the economic impact is far greater than the amounts invested suggest.

Continued political debate

On the initiative of the Socialist Party (Socialistische Partij), the Lower House of Dutch Parliament (Tweede Kamer) recently announced that it will conduct public hearings regarding the position of the private equity industry in the Netherlands. The outcome of these hearings is awaited with interest.

Code of Conduct

Like the British Private Equity and Venture Capital Association (the BVCA), the Dutch Private Equity and Venture Capital Association (Nederlandse Vereniging van Participatiemaatschappijen, NVP) has formed an internal commission. Prompted by the recent controversy surrounding the industry, the commission will investigate whether or not there is a need to update and amend the code of conduct for Dutch private equity houses.

Indirect supervision

An additional development that might have a bearing on the private equity industry is the intention of the Dutch Central Bank (De Nederlandsche Bank, DNB) to apply principle-based supervision on the alternative investments made by pension funds. The DNB, whose tasks include the supervision of insurance companies and pension funds in the Netherlands, is working on eight qualitative criteria to be used as guidelines in assessing whether pension funds adequately and duly manage their risks. Although the criteria have not been made public, the director of the DNB has revealed that the assessment of alternative investments made by pension funds – including investments in private equity funds – will be based on:

- characteristics regarding risks and return;
- portfolio management;
- due diligence;
- contract conditions and monitoring; and
- communication with stakeholders regarding motivations and objectives being pursued.

Sizeable Dutch pension funds (such as ABP and PGGM) have played an important role in the growth of private equity investment, not only in the Netherlands but also worldwide, so the guidelines issued by the DNB could have a substantial impact on the private equity industry as a whole.

Legal developments

Developments in Dutch corporate law will substantially expand private equity funds' freedom to internally organize Dutch companies, as well as provide for additional possibilities to structure transactions. On the regulatory side, new legislation in the field of financial services has come into effect, most of it implementing EU Directives.

Law on private limited companies simplified

Following developments in other EU member states, there has been movement towards a more flexible form of private company with limited liability than the current BV (*besloten vennootschap*).

An Expert Group was commissioned in 2003 by the Dutch Minister of Justice and the State Secretary of Economic Affairs "to formulate recommendations concerning the problem areas and gaps in BV law as identified in practice and the literature". After publication of the Expert Group's recommendations in 2004 to increase the flexibility of, and simplify Dutch law on, BVs, a consultation process was opened on a draft legislative proposal on the subject.

The proposed amendments, when implemented, will alter the character of the BV, which is characterized by a large number of mandatory rules and requirements. The incorporation of a BV will be simplified and the freedom of organization for shareholders will predominate. Shareholders will be free to determine the way their BV is organized and managed. Also, administrative burdens and legal costs could be cut.

However, more weight will be given to the protection of creditors in a number of areas and the personal liability of management board members is likely to be increased.

The main changes anticipated include:

- abolition of the minimum capital requirement for newly incorporated companies, which currently stands at €18,000 ($23,000);

"The incorporation of a BV will be simplified and the freedom of organization for shareholders will predominate"

Author biographies

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Nathalie van Woerkom is a member of the corporate and M&A department of AKD Prinsen Van Wijmen. Her main areas are private equity and M&A transactions.

Van Woerkom graduated from Erasmus University in Rotterdam in 1993 and was admitted to Bar of The Hague in September 1993. She obtained her MBA from Rotterdam School of Management in 2002. Before joining AKD, she worked for Andersen Legal for five years and for Buruma Maris for five years.

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Carlos Pita Cao is a member of the corporate and M&A department of AKD Prinsen Van Wijmen and has been with the firm since 2000. Pita Cao concentrates primarily on private equity transactions national and international mergers and acquisitions, management buyouts and joint ventures. Pita Cao obtained his MA in European and international law at the Catholic University in Brabant in 2000. In 2004 he also completed the post-graduate study programme in EC competition law at King's College London.

Patrick van Min
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(Contributor on tax developments)

Patrick van Min is a tax partner in the multidisciplinary and integrated M&A group of Deloitte in Rotterdam. In the last few years, Van Min has worked on a substantial number of high-end private equity transactions in The Netherlands. Van Min graduated in tax law at the University of Leiden in 1994. Directly afterwards he joined Andersen. As a result of the merger between Deloitte and Andersen, he joined Deloitte in June 2002, where he was appointed partner in 2005.

- a departure from mandatory rules regarding the company's internal organization, enabling the shareholders to determine the internal organization of the company;
- the option of giving certain specific shareholders the right to appoint and dismiss directors;
- shareholders have freedom to assign voting rights as they see fit;
- removal of mandatory limitations on the transfer of shares (*blokkeringsregeling*), while permitting shareholders to prohibit these transfers for an appropriate period of time; and
- elimination of the financial assistance rules as laid down in Section 2:207c of the Dutch Civil Code (Burgerlijk Wetboek).

The BV is the most common form of private company in the Netherlands and is used in almost all buyout transactions. In terms of deal structuring, the private equity industry will benefit from the greater corporate flexibility envisaged concerning the private company with limited liability.

Expectations are that the Bill will be presented to the Dutch Parliament sometime during 2007, though the precise timing is as yet unknown.

Partnerships Act

A Bill to amend the provisions pertaining to Dutch partnerships (*personenvennootschappen*) was passed by the Lower House of Dutch Parliament in early 2005. It has, however, not yet been passed by the Upper House (Eerste Kamer). When implemented, the new rules will replace the existing rules on Dutch private partnerships (*maatschappen*), general partnerships (*vennootschappen onder firma*) and limited partnerships (*commanditaire vennootschappen*).

As it stands, the Bill will introduce the option for partnerships acting under a common name to acquire legal personality (*rechtspersoonlijkheid*), making it possible for the partnership itself to hold legal title to property. Also, the possibility of converting a partnership with legal personality into a BV, and *vice versa*, will be introduced.

A substantial departure from current legislation is that all partners in a partnership acting under a common name will be jointly and severally liable (*hoofdelijk aansprakelijk*) – regardless of whether the partnership has legal personality. An exception will apply for limited partners in a Dutch limited partnership who, as a general rule, will continue to be exempt from joint and several liability. This new liability regime constitutes a substantial change for private partnerships acting under a common name (*openbare maatschappen*) as, under existing Dutch law, each partner in this kind of partnership bears an equal share of liability.

It is uncertain when the Bill will be passed by the Upper House of Parliament. However, this is not likely to occur before the second half of 2007. Tax-related proposals and transitional rules will ultimately be incorporated in a separate Bill.

Cross-border mergers

The EC Merger Directive

As in other jurisdictions, Dutch legislation on legal mergers excludes mergers with companies governed by a foreign jurisdiction, the exception being legal mergers between public companies limited by shares through the incorporation of a *Societas Europaea*. This is expected to change in 2007 with the implementation of Directive 2005/56/EC of October 26 2005 on cross-border mergers of limited liability companies (the EC Merger Directive). The aim of the legislation is to ease mergers between various types of limited liability companies from different EU member states.

The EC Merger Directive allows European cross-border transactions (such as acquisitions) to be structured in the form of a legal merger, rather than as a share purchase transaction, simplifying these transactions.

The execution of a cross-border merger results in: (i) the transfer of all of the assets and liabilities of each of the merging companies to the surviving entity or the new entity created through the merger; (ii) the shareholders of the merging companies becoming shareholders of the surviving company or the new company; and (iii) the merging companies ceasing to exist.

All member states must implement the EC Merger Directive by December 15 2007.

The SEVIC *case*

Despite the implementation of the Merger Directive, the general view is that cross-border mergers between companies from different member states have been possible since the judgment handed down by the EC Court of Justice in the *SEVIC Systems* case on December 13 2005. In *SEVIC*, the EC Court of Justice ruled that a ban on cross-border mergers was, in principle, in violation of the freedom of establishment as laid down in the EC Treaty.

However, *SEVIC* has not led to an increase in cross-border mergers. The judgment is deemed not to provide enough certainty regarding a variety of legal issues. This will be remedied by the Merger Directive, which is expected to be of benefit to a number of European companies.

Financial Supervision Act

An important development on the legal landscape of the Netherlands is the enactment of the Financial Supervision Act (Wet op het

financieel toezicht), which entered into force on January 1 2007.

The Financial Supervision Act consolidated almost all rules and conditions applying to financial markets and their supervision in the Netherlands. The new legislation replaced eight sector-specific financial supervision Acts, including the Securities Trade Supervision Act (Wet toezicht effectenverkeer 1995), the Collective Investment Act (Wet toezicht beleggingsinstellingen) and the Financial Services Act (Wet financiële dienstverlening). As a consequence, the system of supervision of financial institutions (among them, banks, insurers, investment firms and collective investment schemes) existing in the Netherlands is now regulated by one single act and several subordinate regulations.

The Financial Supervision Act also introduced substantive changes to legislation. It brought about a shift from rule-based supervision to principle-based supervision, amended provisions on penalties and their publication and introduced a code of conduct for institutional investors (*institutionele beleggers*).

Disclosure of major holdings

Pursuant to the Financial Supervision Act, every person who acquires or sells a major holding in a company listed on Euronext Amsterdam is required to immediately notify the Dutch Authority for the Financial Markets (Autoriteit Financiele Markten, AFM) regarding the purchase or sale of shares, indicating the percentage category into which the acquisition or disposal falls. The categories are: 0% – 5%, 5% – 10%, 10% – 15%, 15% – 25%, 25% – 30%, 30% – 40%, 40% – 50%, 50% – 60%, 60% – 75% and 75% – 95%. An issuer of shares must inform the AFM without delay about the total changes in their share capital if that capital has changed by 1% or more since the previous notification.

Managing directors and supervisory directors of these companies have more extensive notification responsibilities. They are required to notify any amount of shares and/or options they hold in the company, even if through a purchase or sale the total amount of shares does not fall into a different category.

The EC Takeover Directive

Directive 2004/25/EC of April 21 2004 on Takeover Bids (the EC Takeover Directive) should have been implemented in the member states by May 20 2006; a deadline that the Netherlands failed to meet. Debate in Parliament, in particular on the breakthrough rule regarding defensive anti-takeover measures (*beschermingsmaatregelen*) led to various amendments to the Bill for transposing the Takeover Directive into Dutch law.

The Bill will now be enacted as part of the Financial Supervision Act. Although the Financial Supervision Act entered into force on January 1 2007, the effective date of this specific chapter is expected to be mid-2007.

"The Financial Supervision Act brought about a shift from rule-based supervision to principle-based supervision and introduced a code of conduct for institutional investors"

Mandatory offer: A party, whether acting alone or in concert, that acquires *dominant control* (that is, 30% or more of the voting rights) of a Dutch company whose shares are admitted to trading on a regulated market, is required to make an offer for the remaining shares of that company. Certain exemptions to the mandatory offer requirement apply, including where the holder of the voting rights is an open-end investment company or is a party maintaining dominant control in a company after its initial public offering.

The mandatory offer must be made at a fair price, which is deemed to be the highest price paid by the offeror for the same shares during the year preceding the offer or, if the offeror did not acquire any shares in that period, the average stock exchange share price over that year.

Defensive anti-takeover measures: The proposed breakthrough rule as regards defensive anti-takeover measures has been dropped. However, companies whose shares are admitted to trading on a regulated market may still voluntarily include certain limitations on any defensive anti-takeover measures in their articles of association (*statuten*).

Squeeze-out rights: Under Dutch legislation, squeeze-out proceedings (*uitkoopprocedure*) may be initiated against the remaining shareholders by a shareholder holding 95% of the issued share capital. The Bill on the implementation of the EC Takeover Directive contains provisions on the price to be paid in squeeze-out proceedings after a mandatory or voluntary offer.

Sell-out rights: In respect of the squeeze-out rights described above, a sell-out right is introduced for the remaining shareholders against the offeror if the offeror has acquired 95% of the issued share capital representing at least 95% of the voting rights.

Rules on public offers

New rules on public offers for securities that are admitted to trading on a regulated market in the Netherlands will be contained partly in the Financial Supervision Act and partly in a separate decree to be issued under that Act. The new rules are not expected to enter into force until the second half of 2007.

Public announcement: The rule that a public announcement must be made as soon as "the expectation is justified that agreement on the offer can be reached" will be replaced by a rule requiring a public announcement only once a conditional agreement has been reached between the offeror and the target company. In the event of an unfriendly offer, it will no longer be necessary to make a public announcement immediately after the offeror's invitation to the target company's board to discuss the offer, which is currently the start of the seven-day consultation period. Under the new rules, a public announcement with respect to an unfriendly offer need only be made at the end of the seven-day period.

Certainty of funds

A certainty-of-funds rule, as required by the EC Takeover Directive, will be introduced, entailing that the offeror must publicly announce that payment of the relevant consideration has been secured when it submits the draft offer document to the AFM for approval.

Acceptance period

Under the current rules, the acceptance period for a full offer (*volledig bod*) is at least 20 days, if the offer is friendly. This period will be extended to a minimum of 25 days. The minimum acceptance period for an unfriendly offer will remain 30 days. A maximum period for all types of offers of 10 weeks will also be introduced. Currently, the rules do not contain a maximum period.

Offer document

Under the proposed rules, the requirements regarding the contents of the offer document will be more extensive and detailed than under the current rules. Also, the offer document must be submitted to the AFM for its approval. Subject to a number of conditions, the AFM will accept an offer document that has been approved by the competent supervisory authority in another member state.

Alternext Amsterdam: a new exit option

Flotation as an exit route for private equity funds played little or no role over the last few years in the Netherlands. To promote this as an exit option, Euronext Amsterdam launched '*Alternext Amsterdam*' in May 2006. This is a tailor-made stock exchange for small and medium-sized enterprises (SMEs), much like the Alternative Investment Market (AIM) launched by the London Stock Exchange. Alternext Amsterdam was developed to offer SMEs efficient access to the capital market, enabling them to fund further growth, while

providing transparency and protection for investors. TMC was the first issuer to be admitted to Alternext Amsterdam, in November 2006.

Companies admitted to Alternext Amsterdam are not required to comply with some of the rules and regulations applying to companies admitted to regulated markets. These include the public offer rules and the rules on the disclosure of major holdings. Alternext Amsterdam is a non-regulated market with listing requirements that are considerably less stringent than those of regulated markets. It is subject to the rules laid down by the market operator, Euronext Amsterdam. The chief requirements for admission to Alternext Amsterdam are:

Listing sponsor: The applying company must select and appoint an approved listing sponsor to prepare the listing and assist it throughout its life as a listed company.

Record of two years: The company must have published financial statements for at least two years. The financial statements for the most recent financial year need to be certified by an auditor. Application of IFRS is not mandatory.

Minimum market capitalization: The company must have a market capitalization of at least €2.5 million, if a public offering, or €5 million if a private placement to at least five investors.

Prospectus or offering circular: In a public offering, the company is required to publish a prospectus that meets the requirements set out in the EC Regulation 809/2004 implementing Directive 2003/71/EC of November 4 2003 (the EC Prospectus Regulation) and that is approved by the AFM. In a private placement, the company is required to produce an offering circular, which is, in effect, a prospectus that does not need to be approved by the AFM.

Alternext was launched in Paris in May 2005 and was introduced in Brussels a year later. It has enjoyed considerable success in both France and Belgium, where it comprises more than 70 companies. Although it got off to a slow start (it has only admitted two companies since its launch), expectations are that Alternext Amsterdam will assist in boosting the Dutch exit climate in 2007.

Tax developments

Taxes have historically been an important issue for private equity and venture capital transactions. Both the effective tax rate at the level of the investments and the taxes that are more bound to the acquisition structure have a substantial influence on the overall return on investment.

On both levels, the Dutch tax climate has developed strongly in 2006, with most effects being visible as of 2007 and onwards. The developments took place in both new legislation and the use of new acquisition structures in practice.

Better tax climate for investors

The Netherlands has been known for its competitive tax climate. The Dutch participation exemption (which allows tax effective repatriation of dividends and capital gains) and the extensive treaty network, combined with the possibility to conclude advance tax rulings made the Netherlands favourable both for investments and for use in international tax structures. Also, the Dutch corporate income tax rate of 35% that existed until a few years ago was on the lower side in Europe. Over the last few years, developments in countries surrounding the Netherlands have meant that the Netherlands has lost its competitive edge.

To put the Netherlands back on the map as a favourable location for investments, the Dutch government has made several changes to Dutch tax law. Besides abolishing Dutch capital registration tax (January 1 2006) and an earlier decrease of the Dutch corporate income tax rate, several new steps were taken and became effective on January 1 2007. The general tax climate improved substantially, but not all measures are beneficial and at least some measures require extra attention.

> **"The Dutch participation exemption has been streamlined. It now applies to all investments of 5% or more of the shares in a subsidiary"**

Statutory tax rates

The Dutch corporate income tax rate decreased to 25.5%. For profits lower than €60,000 and €25,000 lower rates (23.5% and 20%, respectively) apply.

Also, the general rate of Dutch dividend withholding tax was lowered to 15%. The more favourable rates as concluded in double tax treaties and as mentioned in the Parent-Subsidiary directive still apply. No withholding tax is due on dividend payments from the Netherlands to qualifying EU companies that own 5% or more of the shares in a Dutch company (with some exceptions).

Dutch participation exemption

The Dutch participation exemption has been streamlined. It now applies to all investments of 5% or more of the shares in a subsidiary. There is no longer a difference between Dutch and foreign subsidiaries. On the other hand, investments of less than 5% will no longer be covered by the participation exemption, even if they are considered strategic business investments.

A special regime applies to participating interests in investment subsidiaries whose profit is taxed at a rate of less than 10%. The value of these subsidiaries must be assessed annually at market value. The parent company is taxed on the value movements, and on the dividend. This dividend is grossed up by a factor of 100/95. The tax payable on the profit of the subsidiary may be set off against the parent company's corporate income tax. An investment subsidiary is defined as a subsidiary whose assets consist for more than 50% of passive investments (such as cash and loans).

Interest deduction on acquisition loans

Until 2007, the interest paid by a Dutch acquisition company on an intra-group loan was potentially deferred for deduction. If certain requirements were met, this interest was directly tax deductible and eligible to be offset to operating profits of an investment by using the fiscal unity concept that exists in the Netherlands. This legislation has been abolished in 2007.

However, already existing anti-abuse legislation on interest in relation to intra-group acquisition loans has been extended to acquisitions outside the group. This means that the legislation also applies to intra-group loans obtained to acquire a company from a third party. Under these rules, interest deduction can be denied if the taxpayer cannot prove that the interest paid is subject to a corresponding effective taxation of at least 10% at the level of the recipient or that both the loan obtained from a related party and the acquisition have business reasons.

In private equity situations, the acquisition as such will undoubtedly have business reasons. However, if a substantial part of the acquisition is financed with an intra-group loan (for example from another company in the fund structure) one could argue about the business reasons for that loan. Luckily, business reasons will also be assumed if the loan is ultimately obtained from a third party (that is, a bank). So it is essential that, in such financing, the link between the overall financing and the debt at Dutch level can be shown.

New Dutch acquisition vehicle

Another important development for private equity in the Netherlands is the use of a coop (cooperation). The coop is one of the oldest Dutch legal entities but is rapidly gaining territory as an alternative to Luxembourg investment vehicles.

The coop has a number of features that is ideal for private equity investors. It can apply the Dutch participation exemption and the Dutch tax treaties, it can be included in a fiscal unity and is not subject to dividend withholding tax. Besides, the members of the coop should not be subject to tax in the Netherlands and an advance tax ruling can be

obtained on tax structures with a coop.

The requirements of the coop in international structuring are similar to other options but, in practice, a coop allows a higher level of flexibility. This is both the case in setting up a structure and upon a future exit. Many the private equity investors have started using a coop in their acquisition structures.

Back on form

The Dutch private equity market has expanded into a fully developed market. This has been reinforced by the strong presence of international venture capital companies in the Netherlands. The Netherlands has adopted a number of their trends and practices, including increased reliance on auction sales and syndicated transactions. Given the strong funding position of the private equity and venture capital players, the attractive exit climate and the excellent economic conditions, it is expected that the number of private equity and venture capital transactions will continue to grow in 2007.

From a public relations perspective, the private equity and venture capital industry in the Netherlands was forced into the defensive during 2006. As a result, the Lower House of the Dutch Parliament is planning to conduct hearings into the private equity industry.

The Dutch Private Equity Capital Association is also investigating whether the code of conduct for Dutch private equity houses should be amended and the Dutch Central Bank is working on criteria that will be used as guidelines to assess investments made by pension funds.

Although this seems to suggest greater regulation, contrasting developments in Dutch corporate law, such as the simplification of Dutch law on private limited companies that includes elimination of financial assistance rules and a fundamental departure from mandatory rules regarding the company's internal organization, will increase the freedom of private equity funds to internally organize Dutch companies and provide additional possibilities for structuring transactions.

The Dutch tax climate has again become attractive for private equity investors and venture capitalists. Both new legislation and the use of new acquisition structures mean that the Netherlands has regained its competitive advantage.

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