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Leveraged finance, particularly with respect to acquisition financing, has been an expanding asset class for many years. As of the fourth quarter of 2018, leveraged loans outstanding totalled US$1,147 billion and high-yield bonds outstanding totalled US$1,256 billion. The average annual growth rate for leveraged loans outstanding (2000–2018) equalled 15.8 per cent and for high-yield bonds (1997–2018) equalled 6.5 per cent.¹ In 2018, leveraged finance loan totals for acquisition finance surpassed the previous records set in 2007.²

The leveraged finance markets and these markets’ participants grow deeper and more sophisticated year over year. The playing field for acquisition finance, particularly for private equity deals, remains in large part an issuer-controlled game with an increasing number of new financing sources clamouring to become involved. As has been noted by many, credit controls (covenants and collateral coverage) remain soft and continue to weaken in some cases. That said, default rates are at the low end of the historical range and new piles of capital continue to be accumulated to support acquisition financing. As discussed in the Introduction that follows, regulators are indicating concern about the leveraged loan market in the case of an economic downturn but, to date, that does not seem to have stifled the appetite for new deals and associated financings.

For lawyers, this is a great area of practice. There is lots of activity given the size of the asset class; everything from new issuance, to refinancings, to work outs and insolvency proceedings. But to be an effective practitioner in the area, more is required than occasionally dabbling in leveraged finance transactions. Most lawyers who successfully practice in leveraged finance do it full time. Knowing ‘market terms’ is considered to be very helpful, if not critical, to success in this area.

This volume is intended to introduce the newcomer to the legal basics involved in leveraged finance, particularly acquisition finance, so that he or she is grounded in the underpinnings of the practice area. It is also intended to be a helpful update for the more seasoned practitioner with respect to what is new and what is being talked about in leveraged finance deals.

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Thanks to my partners Casey Fleck and Doug Landy, and my associates Chris Hahm, James Kong and George Miller, for their help in editing the volume and preparing the Introduction that follows.

Marc Hanrahan
Milbank LLP
New York, NY
September 2019
Chapter 1

INTRODUCTION

Marc Hanrahan

I OVERVIEW

The world of leveraged finance is full of terminology that, to the uninitiated, may seem overwhelming. The terminology is helpful shorthand for features of the market, documentation and risk allocation dynamics that have developed over time and lend themselves to shortened descriptions. Some of the terminology is explained in this Introduction and the chapters that follow. To start with the most basic term, ‘leveraged finance’ to most market participants refers to finance (debt or another form of similar capital) that is provided to speculative grade credits (ie, not investment grade). The forms of this credit, the credit providers and the arrangements under which it is offered can vary widely and have morphed over time. What follows is an overview of some of the most common leveraged finance products, together with a bit of background around who are the players and what are some of the issues involved in recent days.

Leveraged financings can include working capital facilities, whether through asset based lending (ABL) arrangements revolving credit facilities or more permanent elements of a company’s capital structure (including bridge financings, usually with a high-yield bond take-out financing, or, in European financing, interim financing agreements.

Often, a leveraged company’s capital structure consists of a senior debt layer and a junior debt layer, in addition to the equity portion of the capital structure. The senior debt layer has traditionally been filled with bank loans (whether in the form of first lien term loans, revolving credit facilities or ABL revolving credit facilities), and the junior debt layer has traditionally been filled with bonds (whether in the form of subordinated notes, senior unsecured notes, mezzanine notes and, especially in Europe, holdco notes, which are ‘structurally subordinated’ to the senior debt layer). Over the past 30 years, these two layers have become increasingly differentiated, segregated and blurred, allowing issuers, financial sponsors and financial intermediaries the ability to access different aspects of the capital markets to optimise a capital structure given market demands, regulatory requirements and other considerations. Over the past 10 years, the markets have seen the senior debt layer of the capital structure often filled out with an ABL revolver (secured by a first lien on the company’s working capital assets – inventory and accounts receivable) and term loans (secured by a first lien on the company’s remaining assets), with ‘butterfly’ junior liens (where the term loans are secured by a second lien on the company’s working capital assets and the ABL revolver is secured by a second lien on the company’s assets other than the working

1 Marc Hanrahan is a partner at Milbank LLP.
2 In the US, the Loan Sales and Trading Association (LSTA) publishes a helpful glossary of terms relating to leveraged finance.
capital assets). At certain times in the markets and more generally in certain industries, the ‘senior’ layer of the capital structure has been provided by relatively small ABL revolving credit facilities and the ‘junior’ layer of the capital structure has been provided in the form of secured high-yield bonds, because of dislocation in the syndicated loan market; these capital markets are dynamic and the participants adapt accordingly. In addition, over the past five years, the United States syndicated loan markets have increasingly accommodated ‘stretch’ first lien loans, where the first lien loans have provided leverage levels sufficient to make junior debt layer unnecessary.

The junior debt layer of a leveraged company’s capital structure was traditionally provided by ‘high yield’ or ‘junk bonds’. These instruments typically involve a fixed rate of interest and significant call protection, whereas loans have traditionally involved floating interest rates and have allowed for prepayments with only modest, if any, prepayment premiums. In the United States, these instruments are ‘securities’ and, therefore, are subject to the increased liability standards of the securities laws. In years past, many of these bonds were issued as ‘subordinated’ debt, meaning that the bonds were contractually subordinated in right of payment to the senior debt layer of the capital structure. Over the past 10 years, fewer and fewer bonds have provided for contractual payment subordination, requiring the senior lenders to be comfortable with their collateral as the only source of ‘effective subordination’ of the junior debt layer of the capital structure, or providing the senior lenders with priority claims with respect to collateral, where the bonds are secured by a lien with junior priority to the lien securing the senior debt layer of the capital structure. In addition to competition from ‘stretch’ first lien loans, the junior layer of the debt capital structure has increasingly been filled with syndicated second lien loans.

Over the past 15 years, the senior and junior layers of a leveraged capital structure have often been a bifurcation between first lien and second lien debt. With robust syndicated loan markets over this period, we have increasingly seen a first lien term loan and revolver and a second lien term loan provide the entire debt financing for an acquisition. In some industries, especially the oil and gas exploration and production industry, the lien between the ‘senior’ and ‘junior’ layer of the capital structure has become further blurred, with ‘1 and ½ lien’ and even ‘1 and ¼ lien’ and ‘1 and ⅛ lien’ structures, where senior secured debt, either in the form of term loans or high-yield bonds, where the priority of the liens securing the debt is allocated pursuant to contractual intercreditor agreements or trust arrangements.

Recently, for regulatory reasons described below as well as ratings agency considerations, and financial sponsor’s financial return requirements, a portion of the third party financing in connection with acquisition finance has sometimes been provided in the form of preferred stock. Preferred stocks allows investors to achieve fixed income returns (whether in the form of fixed or floating dividend rates), with some debt-like covenant protections. If structured correctly, preferred stock can obtain equity treatment for regulatory and ratings purposes. As a result, preferred stock is being increasingly used in leveraged capital structures.

II OVERVIEW OF LEVERAGED DEBT PRODUCTS
What follows is additional detail regarding the financial products most commonly used in leveraged acquisitions today.
Secured term loans

Secured term loans are generally thought to be the some of the less risky debt in a leveraged capital structure. These loans are usually secured by substantially all of the assets of the borrower and its subsidiaries. The covenant controls are typically the tightest of any debt in the capital structure. A borrower is usually required to provide to the lenders of the term loans more financial and other information than that received by other debt purchase. The interest rate is typically based on LIBOR or some other floating measure to mitigate the cost to lenders of changes in interest rates. Secured term loans are also, generally the ‘cheapest’ debt on the leveraged borrower’s balance sheet. Since secured term loans are viewed as less risky, lenders require less compensation in the form of interest and fees for taking on the reduced risk.

That said, the leveraged loan market has become more ‘borrower-friendly’ over time. The best example of this trend is the state of play today with respect to financial covenants. Secured term loans historically enjoyed the benefits of one or more financial covenants, which required a borrower to live within a maximum leverage ratio or maintain an interest coverage ratio. While there are still deals in which these sorts of financial covenants are present, a large percentage of leveraged loan transactions have adopted what has been come to be known as a ‘covenant-lite’ construct. In a covenant-lite deal, there are no financial covenants that exist contractually for the benefit of the term loan lenders. If there is a revolving credit facility in the capital structure, a single financial covenant (usually a maximum leverage ratio) is imposed for the benefit of the revolving lenders only. The revolver covenant usually includes a significant cushion to the borrowers’ business plan and is only applicable when significant drawings are outstanding under the revolving facility. In addition to covenant-lite arrangements, large syndicated term loan facilities increasingly provide flexibility to incur additional debt, make investments and pay dividend so long as the borrower complies with various financial metrics. This trend has been referred to by some practitioners as the ‘convergence’ of term loan covenant controls with bond-style covenants described below.

Secured term loan facilities are usually provided by a group of lenders. One of the lenders in the group typically serves as an agent for the group, and one or more of the lenders will underwrite the term loan facility as an initial matter and subsequently syndicate all or a portion of the facility to other lenders (taking a fee for their efforts along the way). For large term loan facilities, there can be tens of lenders in the ultimate syndicate of lenders. For smaller deals, the entire amount of the facility may be provided and held by a smaller group of lenders. These arrangements are sometimes called a ‘club deal’.

Regulations that came out of the financial crisis known as the Leveraged Lending Guidelines put limitations on the amount of leveraged debt that could be underwritten by regulated institutions for a given borrower. In response, a new category of lender, now commonly known as ‘direct lenders’, has emerged to offer greater degrees of leverage in connection with acquisitions and other transactions. These entities are institutional investors that are less regulated than banks, and have significant amounts of capital to invest. Unlike some other players in the market, these lenders, for the most part, do not look to underwrite and distribute loans, but rather to invest and hold the loans on their books. Because of the absence of an underwriter or arranger in the case of these investors, they deal more directly with the borrower, hence the title ‘direct lenders’. Recent regulatory developments have called into question some aspects of the Leveraged Lending Guidelines. However, direct lenders appear to have ensured a continuing place for themselves because of their ability to commit
significant amounts of capital quickly, without the market ‘flex’ provisions discussed below that allow arranging banks that intend to syndicate the loans with flexibility to adjust the terms of the loans based on market reaction.

Much of the growth in size of the leveraged loan market can be attributed to the fact that, while in days of old leveraged term loans were relatively illiquid financial assets, today that is no longer true. There are now active trading desks around the world that can make a market in most sizeable term loans. The development of this liquidity has attracted new investors. Trade associations such as the LSTA in the US and the LMA in the UK have helped to organise the term loan market and provide useful information to participants thereon, making the market for loans more efficient.

ii High-yield bonds

High-yield bonds are non-investment grade debt instruments that typically have fixed interest rates and durations ranging from five to 10 years. They usually include call protection for a period of several years after issuance that requires payment of a premium if they are repaid during this period. Unlike secured term loans, they are treated as ‘securities’ for the purposes of the United States securities laws, which imposes heightened liability and typically results in enhanced disclosures in connection with their marketing, compared to the disclosures legally required in connection with bank loans. They can be secured or unsecured and can constitute part of the junior debt layer of a company’s capital structure through a junior lien, through payment subordination, or through structural subordination (issued from a ‘holdco’ without the benefit of subsidiary guarantees). Traditionally, in the United States, they were issued in private placements and registered under the United States Securities Act afterwards pursuant to ‘registration rights’ granted to the bondholders in the private placement. Increasingly, high-yield bonds are sold without these registration rights as the ‘144A for life’ market has expanded, allowing issuers to limit access to their financial information to bond investors (rather than competitors that could have reviewed the financial information filed with the US Securities and Exchange Commission) and to avoid the additional expenses of compliance with SEC reporting.

Recently, the high yield market, like the syndicated loan market, has been perceived as more robust than the IPO market for the types of leveraged companies that are typical portfolio companies of private equity sponsors. As a result, over the last few years, we have seen high-yield bonds serve as an interim step before an IPO or sale of the portfolio company. These bonds are typically issued by a holding company, to they are structurally subordinated to the original acquisition financing debt capital structure. The proceeds of the bonds are used to pay a dividend to the financial sponsor. The bonds have smaller redemption premiums, allowing the issuer to redeem the bonds if they are taken public or sold, with less ‘breakage’ costs from the redemption premiums. More recently, some sponsors have used these subsequent holding company financings as a way to effectively reduce the size of their initial ‘equity check’, by using these holding company high yield issuances as soon as months after the closing of a leveraged acquisition, with the proceeds being used to pay a dividend to the financial sponsor.

iii Revolving facilities; ABL facilities, first out arrangements

Most companies with a leveraged capital structure require a line of credit to finance the working capital needs of their business. A classic leveraged acquisition capital structure would include a revolving credit facility (a ‘revolver’) to meet this need. A revolver is sized to fit the
specifics of a company’s working capital cycle and would usually include the option to make drawings under the revolver in the form of loans or the issuance of letters of credit or bank guarantees. A revolver is a line of credit that can be borrowed, repaid and reborrowing as a company’s working capital needs require.

The revolver for a leveraged acquisition usually has a shorter maturity than the term loans in the capital structure, and is commonly provided by a subset of the financing sources providing the secured term loan financing. The revolver is otherwise pari passu with the secured term loans, meaning it has the same credit risk as the term loans in the case of an insolvency.

A somewhat new feature being added to revolvers is what is commonly referred to as ‘first out’ or ‘super senior’ status. Under these structure, the revolver is not pari passu with the secured term loan. Rather, it is entitled to receive first proceeds of recovery on collateral or payments in a distress scenario to ensure repayment of the revolver ahead of term loan lenders. These arrangements are more commonly used in credits where lenders willing to provide a revolver are scarce. Differences exist between the specifics of the structures used to document these facilities in the US and Europe, but structures on both sides of the Atlantic have the same purpose: to ensure that, in a distressed scenario, the revolver is repaid in full before the term loan.

An ABL facility is much like a revolver but with enhanced credit support. An ABL is not pari passu with the secured term loans but, instead, has a first priority claim on selected assets (usually inventory and receivables) ahead of the claims of the secured term loan and other debt.

Under the terms of an ABL, a borrower is only permitted to make borrowings up to a percentage of the borrower’s inventory and receivables deemed financeable. Hence, an ABL is considered less risky in that it has its own separate pool of readily monetisable collateral designed to support borrowing under the ABL. Because an ABL is less risky, it is also less expensive and is often used as a substitute for a classic revolver where a borrower’s inventory and receivables provide suitable support. Some of the savings on interest is offset by the fact that a typical ABL requires a borrower to report additional information to the ABL lenders along with third-party assessment of collateral values to ensure that the borrower is adhering to the specific requirements of the ABL structure.

iv Leveraged finance documentation and process

Generally speaking, leveraged finance transactions can be differentiated between ‘committed financings’ and ‘best efforts financings’. In committed financings, one or more parties contractually commit to provide the relevant financing at a later point in time to the financial sponsor or borrower. After the commitment stage but prior to funding, ‘long form’ or ‘definitive’ documentation is prepared to set out the final terms of the financing. In best efforts financings, one or more parties under taken to arrange the relevant financing for the borrower or financial sponsor, but there is no obligation to provide that financing. In the case of best efforts financings, the borrower or financial sponsor only obtains the financing if the marketing process is successful and on the terms dictated by the market.

In committed financings, the documentation entered into at the commitment stage typically includes:

a a ‘commitment letter’, which sets out the financing sources’ commitments to provide the financing described in a series of attached term sheets and contains the conditions to the financing sources’ obligations;
b a ‘fee letter’, which contains certain of the economic terms of the financing sources’ commitments, as well as containing any ‘flex’ rights (described below) that the financings sources have to alter the terms of the financing based on marketing conditions; and

c an ‘engagement letter’, if the financing contemplates a high yield bond offering that will hopefully will be used in lieu of any bridge financing commitment.

Generally speaking, acquisition finance uses committed financings so that the buyer and seller have confidence that the capital will be available to fund the transaction. About 15 years ago, the conditionality of the financing commitments in connection with United States public company acquisitions was significantly limited in what became known as ‘SunGard’ conditions (the name of the target company in the first transaction in which these provisions appeared). Broadly speaking SunGard conditions limit representation and warranties with respect to the target that are required to be made as a condition to funding to those negotiated in the acquisitions agreement. Over time, the limited conditionality of SunGard provisions expanded into acquisition financing involving private companies as well and is standard in most acquisition financing commitments in the United States.

In the UK, acquisition financing commitments involving public companies have been subject to the ‘Certain Funds’ of the UK Takeover Code. Broadly speaking, this regulation severely limits the amount of conditionality around funding committed finance so as to give public shareholders certainty of closure once a deal is announced. This limited conditionality has spread to the financing for many private transactions and other transactions that are not subject to the Takeover Code as financial sponsors and other buyers’ have sought to burnish their bids with aggressive financing proposals.

While commitment letters describe many of the terms the financing to be provided, they only include term sheets that detail some, but not all, of the specifics of the financing documents. Final details of the financing were historically negotiated in the long form or definitive documentation, based on reference to market conditions, comparable transactions arranged by the financing sources, as well as comparable transactions involving the financial sponsor and the industry in which the company operates. When the capital markets were turbulent, especially during the extreme turmoil in the 2008–2010 time period, the negotiations around the definitive documentation often became contentious, as financing sources modified terms that were not specifically spelled out in the commitment letters to reflect the current state of the financial markets. Ever since the financial markets rebounded, financial sponsors and other borrowers have been limiting the amount of terms left open for negotiation in the definitive documentation stage. The length of the term sheets has also expanded, so that more and more terms are covered explicitly and the remaining terms are now commonly defined by reference to a specific precedent agreement so that less and less is left to be negotiated later. Initially the referenced precedent transactions were transactions that the financial sponsor and financing source had been involved in in the past or precedents that pertain to an industry in which the borrower operated. However, with the accommodative debt capital markets of the last few years, referenced precedent transactions have become as likely to be transactions that the financial sponsor or borrower (or their law firm) were not involved in, but felt were generally attractive due to their terms. All this has meant that fewer and fewer items are left to be negotiated with the market and that especially attractive terms quickly spread from one transaction to another transaction.

One aspect of documentation for committed financings that are expected to be syndicated is the inclusion of what are known as ‘flex provisions’. These provisions, usually included
in the fee letter so as to be less readily subject to broad disclosures, outline certain specific provisions of the financing referenced in the commitment letter or attached term sheets which the financing source has the option to charge or ‘flex’ if, in the process of marketing the debt, potential investors do not accept the committed terms. The flex provisions are usually quite specific and detailed (as opposed to broad terms or categories) and are subject to significant negotiation between borrower and financing sources at the commitment stage. It should be noted that direct lenders often have an advantage over other commitment parties with respect to flex provisions. Since direct lenders do not typically syndicate the debt they commit to provide, their terms are usually set at the commitment stage and their documentation does not usually include flex provisions. Hence, from the borrower’s perspective, the terms of financing provided by a direct lender at the commitment stage may be preferable to the terms of a commitment to be sold to the market that could be flexed based on market reaction.

III REGULATORY DEVELOPMENTS

Leveraged lending is subject to various regulations in jurisdictions around the world. The most significant regulatory development in recent years, however, has been the issuance of guidance by regulatory authorities in the US and Europe with respect to acceptable standards for leveraged lending transactions.

In the US, in 2013 three federal bank regulatory agencies, namely the Board of Governors of the Federal Reserve (the Federal Reserve), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), jointly issued guidance regarding leveraged lending (the US Guidelines). The US Guidelines replaced prior, pre-crisis guidance issued in 2001, and apply globally to US chartered banks, and to loans made by the US-licensed branches and agencies of foreign banks.

The US Guidelines are a comprehensive set of quantitative and qualification requirements for regulated banks engaging in leveraged lending activities. Among other requirements, banks subject to the US Guidelines must (1) establish a sound risk-management framework that includes risk rating for leveraged loans; (2) have strong underwriting standards, including valuation standards; (3) manage their deal pipelines; and (4) undertake stress testing, reporting and analytics.

The US Guidelines also suggested quantitative, numerical limits on banks’ ability to make certain highly leveraged loans. The US Guidelines specifically exclude certain other types of debt (e.g., ABL facilities and high-yield bonds). In particular, noting that the basis on which any leveraged loan is extended must be the borrower’s ability to repay, the US Guidelines note that a level of leverage in excess of six times measured cash flow would raise supervisory concerns under most circumstances. The colloquial effect of the implementation of the US Guidelines has been to discourage certain previously used, highly leveraged structures, and to move business from the bank lenders to the non-bank lenders. In 2018, there were discussions among the regulators as to whether the US Guidelines should be re-evaluated based on the evidence and experience of the past five years.

In 2017, the European Central Bank (ECB), issued its own guidance relating to leveraged lending. Like the US guidelines, the ECB’s pronouncements are not legally binding, but are expected to be largely followed by major credit institutions in the EU Member States. While there are differences between the US and ECB guidelines, the similarities are strong. Like the US guidelines one of the strongest features is the discouragement of providing financing when total debt exceeds six times EBJTOA.
Introduction

In the US, on 11 September 2018, five federal agencies, including the Federal Reserve, the OCC and the FDIC issued the Interagency Statement Clarifying the Role of Supervisory Guidance (the Guidance). The Guidance noted that supervisory guidance, such as the US Guidelines, does not have the force and effect of law, and is not the basis for enforcement actions.

While both the US and European guidelines are not ‘law’, to date they have been taken very seriously on both sides of the Atlantic.

In 2019, the US Congress and regulators have begun examining whether growth in the leveraged loan market has created a systemic risk to the US financial system. As one example, on 19 April 2019, Senator Sherrold Brown of Ohio sent a letter to Treasury Secretary Mnuchin requesting that the Financial Stability Oversight Council (FSOC), which Secretary Mnuchin chairs), further investigate risks from the leveraged lending markets.3 In response, in its meeting of 30 May 2019, FSOC reviewed the corporate debt and leveraged lending markets. Minutes from the meeting stated that ‘banks’ exposures to leveraged lending . . . were relatively limited and there did not appear to be significant concentrations’.4 FSOC agreed to continue to assess these risks and issues with other agencies. In Europe, on 26 August 2019, in a report on Risks and Vulnerabilities in the EU Financial System, the Joint Committee of the European Supervisory Authorities (ESAs) stated that ‘[r]isks related to the leveraged loan market . . . in the financial sector should be further explored and identified . . . [s]upervisors have raised concerns about a possible underpricing of risks’.5

IV CONCLUSION

The legal considerations involved in leveraged finance are considerable and complex. The overview above only scratches the surface at the highest levels, but hopefully provides an overview of the landscape involved that will enable the reader to more readily absorb the jurisdictional detail that follow in this volume.

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Chapter 2

ARGENTINA

Tomás Allende

I OVERVIEW

The M&A market has been increasing since the new administration took office as of late 2015. Many regulations affecting foreign investment were removed, which has helped to turn around a declining trend in M&A activity, albeit at a slower rate than was expected by most in the business community. Recent activity has been focused mainly on the energy and finance sectors, especially fintech, and also on the agricultural sector.

Once again, we have started to witness commercial banks and some private equity funds providing financing for M&A transactions together with a few acquirers that used international capital markets. Foreign players have increased their participation in transactions.

During the second half of the year 2018, mainly because of political, structural, internal and external issues, companies operating in capital markets greatly underperformed, and a drastic and unavoidable devaluation of the Argentine peso soon followed. Inflation skyrocketed, and the government was forced to request a loan from the IMF. The news was not well received by the population or the business community, and, therefore, devaluation and inflation gave no respite.

The first half of the year 2019 was governed by economic instability, uncertainty and expectations regarding the presidential elections causing investors to look at Argentina with higher distrust and resulting in a decrease of transactions in the M&A market.

On 8 August 2019, a primary ballot took place in Argentina where the opposition’s presidential candidate had a great election result.

Immediately upon these results and given the massive transfer of dollars outside the country, which impacted on the foreign exchange rate, the incumbent administration has enacted several foreign exchange regulations. According to the outcome of the presidential elections, these regulations may be temporary.

On 27 October 2019, Alberto Fernández and his party won the presidential elections so a new scenario is expected as of 10 December 2019 with big uncertainties about future political decisions. Given the results were not like the ones of the primaries, a balanced Congress coupled with the fact that important jurisdictions remain under Macri influence, it is expected that any such decisions shall be made by consensus.

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1 Tomás Allende is a partner at Beccar Varela. The author wishes to thank Marina Heinrich, Andres Schreiber, Maria Ines Cappelletti, Lujan Calliaci and Victoria Rabasa for their contribution.

2 TTR Blog made a report that shows that M&A activity for the first half of 2019 was US$2.342 million and 65 operations. This shows a decrease of 55.91 per cent in the amount and a decrease of 45.38 per cent in the number of operations in comparison with the same period of 2018. TTR Blog; ‘Informe Argentina 2T2019’, 2019 (available at: https://blog.ttrecord.com/informe-argentina-2t-2019/).
II REGULATORY AND TAX MATTERS

i Regulatory matters

Anti-money laundering and corruption regulations

Anti-money laundering regulations always have an impact in transactions. Argentina is one of the members of the Financial Action Task Force (FATF) and the FATF of Latin America and has incorporated its recommendations into its legislation. In Argentine law, money laundering is a specific criminal offence that can be imputed both to legal entities as well as natural persons. The specific authority in charge of the investigation and the prevention of money laundering and terrorist financing is the Financial Information Unit, an agency responsible for issuing regulations and for monitoring compliance with money laundering, among other things. This has an impact on the financing of acquisition as, pursuant to local legislation, certain types of companies and individuals (which include financial entities, and certain government registries and agencies, among others) are required to report suspicious transactions to the Financial Information Unit and carry out ‘know your customer’ procedures.

These requirements are not different from those implemented by most countries, as they are very much in line with international guidelines. They do not affect debt financing any differently than what occurs in most countries, although of course the actual enforcement of these policies is always country-specific.

Through Law 27,401, a corporate criminal liability regime was introduced in Argentina, in force as of March 2018, which provides for effective collaboration agreements, and heavy fines of up to five times the undue benefit obtained by the legal entity, among other civil and administrative penalties for any bribery-related offenses as well as for irregularities in the books and records. Notwithstanding, in some cases, under this regime, companies could exempt themselves from liability if they had developed a robust anti-bribery and corruption compliance programme, considering the risk profile the companies’ operations have in Argentina.

In this sense, the Anti-corruption Office, an organism responsible for the prevention and investigation of practices opposing Inter-American Convention against Corruption, has elaborated guidelines for the implementation of an adequate compliance programme, consisting in recommendations and international best practices.

The guidelines describe 13 principles as elements of the programme. They are top management’s support of the programme; having an ethical code, policies and procedures of integrity; integrity in public tender processes and other interactions with the public sector; training of directors, administrators and employees; having internal whistle-blower systems; protection to whistle-blowers; internal investigations; third-party due diligence; due diligence in corporate transformation process; having a compliance officer; periodic risk assessment; and periodic monitoring and assessment of the adequacy of the programme.
**Foreign exchange regulations**

A major regulatory concern in any type of foreign financing is the existence of foreign exchange controls that may somehow restrict the flow of funds in and out of the country. This has always been a hot topic in Argentina, with a long history of strict controls. In this regard, Argentine law requires, as a general rule, that all transfers of foreign currency to and from the country are carried out through a licensed financial entity or a foreign exchange institution.

Recently, Communication ‘A’ 6770 was issued by the Argentine Central Bank. This regulation imposes certain restrictions as follows:

- **a** legal entities (whether Argentinean residents or not) must obtain prior consent in order to purchase foreign currency (albeit, there are certain exemptions);
- **b** loans granted by financial entities denominated in foreign currency should be converted into Argentinean pesos within five business days of the disbursement date;
- **c** exports proceeds should be converted into Argentinean pesos within five days of their collection or within 180 calendar days (a term that is reduced to 15 calendar days if the export is related to commodities or with a related counterparty); and
- **d** dividends payable to foreign shareholders must obtain prior consent.

It is expected that these regulations will be amended under the new administration and that new and more severe controls will be imposed as a way of protecting the dollar outflow.

**ii Tax matters**

The most common tax issues concern income tax and value added tax.

There are several issues affecting acquisition financing in this jurisdiction that tend to determine the viability of a transaction.

The acquisition of a company can be carried out as a stock purchase or as an asset purchase, the latter having a special procedure of transfer as an ongoing concern. Transfer of assets or transfer as an ongoing concern (the transfer of assets in bulk regulated by a special law) is taxed at 30 per cent of the value of the transferred assets, minus acquisition costs and expenses. Furthermore, VAT of 21 per cent is applied to the purchase of all movable assets, whereas certain capital goods are taxed with VAT of 10.5 per cent.

Pursuant to the Income Tax Law, the sale of shares is levied for:

- **a** Argentine legal entities: at a 30 per cent income tax rate over the difference between the purchase value and the acquisition cost;
- **b** Argentine individuals:
  - would be exempted as long as the transfer is: a public offer placement authorised by the Argentine Securities and Exchange Commission (CNV); made on markets authorised by the CNV (such as MAE and ROFEX) under segments that assure the time-price priority; or carried out through an acquisition or exchange public offer authorised by the CNV; and
  - if conditions set forth above are not met, the Argentine individual would be subject to a 15 per cent income tax rate over the difference between the purchase value and the acquisition cost; and
Foreign shareholders:
- if a resident of a cooperative jurisdiction\(^3\) and the funds come from a cooperative jurisdiction: (1) the foreign beneficiary would be exempted as long as the transfer is: a public offer placement authorised by the CNV; made on markets authorised by the CNV (such as MAE and ROFEX) under segments that assure the time-price priority; or is carried out through an acquisition or exchange public offer authorised by the CNV; and (2) if conditions set forth in (1) are not met, the foreign beneficiary would be subject to a 15 per cent income tax rate, which the beneficiary can choose to apply over: a 90 per cent net presumed income (thus reaching an effective 13.5 per cent rate on the gross sale price); or the effective net income, (i.e., the gross sale price less the acquisition cost); and
- if a resident of a non-cooperative jurisdiction or the funds come from a non-cooperative jurisdiction: a 35 per cent income tax rate will apply over a 90 per cent net presumed income (thus reaching an effective 31.5 per cent rate on the gross sale price).

The tax treatment mentioned above may vary if the foreign shareholders are tax residents of a state that has a double tax treaty in force with Argentina.

In September 2018, through Decree No. 813/2018, the executive branch amended the VAT Regulatory Decree to adapt it to the last amendments introduced into the VAT Law by Law No. 27,346 and Law No. 27,430. It should be noted that according to the VAT Regulatory Decree, regarding services rendered in Argentina by foreigners, the suppliers, recipients and intermediaries will be considered Argentine residents if residence conditions set forth in income tax law are met or if they have a fixed place in Argentina. Regarding digital services that are exploited or used in Argentina and rendered by foreigners, the suppliers and intermediaries will be considered Argentine residents if residence conditions set forth in income tax law are met or if they have a fixed place in Argentina.

**Stamp tax**

Stamp tax is a local tax applied individually by each jurisdiction to instruments that have some sort of economic value and are either executed in Argentina or have effects in Argentina. Since each local jurisdiction is in charge of the application in its own territory, this presents a challenge when a single transaction has effects in many jurisdictions, as the transaction may be taxed differently according to the jurisdiction at hand. The stamp tax rate varies per jurisdiction but is usually between 1 and 1.5 per cent of the amount of the transaction that applies to said instrument.

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\(^3\) Non-cooperative jurisdictions are countries or jurisdictions without exchange of information with Argentina (i.e., there is no exchange of information treaty or double tax treaty with a broad clause of exchange of information between this country and Argentina, or there is no effective exchange of information although this kind of treaty is in force. The list of ‘non-cooperative countries’ should be determined by the executive branch following such parameters (still pending for 2019).

However, through Section 7 of Decree No. 279/2018 (published in the Official Gazette on 9 April 2018), the executive branch established that, until the list of ‘non cooperative countries’ is regulated, the list of ‘cooperative countries’ in force for 2017 must be considered (available at: www.afip.gob.ar/jurisdiccionesCooperantes/#ver).
There are certain exemptions and ways to mitigate this tax, for example, through the existence of special regulations that allow the consideration of payments (or exemptions) of stamp tax in other jurisdictions, or if the transaction is executed through a reversal letter mechanism. The latter is a contractual mechanism in which one party sends a written offer and establishes that it will be deemed accepted if the recipient performs a specific positive action (for example, payment or delivery of goods). This mechanism has been declared by courts as a legal contractual mechanism, and that stamp tax cannot be levied on it. However, there are certain limitations to this procedure as, for example, the mechanism for the registration of a pledge of assets in every jurisdiction sets forth the need to instrument the contract as a single agreement.

**Income tax withholding**

With regard to withholding tax, interest paid by Argentine companies to foreign banks or financial entities (1) under the supervision of the relevant central bank or similar governmental authority, and (2) located in: jurisdictions not listed as null or as low-tax jurisdictions by the Argentine tax authority; or jurisdictions that have signed exchange of information agreements with Argentina and have internal rules stipulating that no banking, stock market or other secrecy regulations can be applied against requests of information by Argentina’s tax authorities, are subject to a 15.05 per cent withholding tax over gross payments (17.7163 per cent if the Argentine payer agrees to bear the withholding tax himself or herself).

Interest paid by Argentine companies for the import of movable assets (except automobiles) is also subject to a 15.05 per cent withholding tax over gross payments (17.7163 per cent if the Argentine payer agrees to bear the withholding tax himself or herself) provided that the loan was granted by the supplier.

In case of any other interest payment to foreign beneficiaries, a 35 per cent withholding tax rate applies over gross payments (53.8462 per cent if the Argentine payer agrees to bear the withholding tax himself or herself).

However, the tax treatment mentioned above may vary if the interest payment is made to tax residents of states that have a double tax treaty in force with Argentina. Finally, no withholding tax applies on principal repayments.

**Debit and credit tax**

This tax is levied on debits and credits in bank accounts held at Argentine financial institutions. Additionally, all transfers of funds are subject to this tax, when made using organised payment systems in lieu of those local accounts. The general tax rate is 0.6 per cent for debits and credits, and 1.2 per cent when the transfer of funds is made through organised payment systems in lieu of local accounts (currently being 33 per cent of this tax paid computable by the taxpayer against income tax). There are several exemptions applicable to finance transactions, including debits relating to time deposits, credits relating to loans granted by banks, and credits or debits relating to advances of discount operations.
III SECURITY AND GUARANTEES

The most common types of security are mortgages, pledges of shares, pledges of assets and security trusts (over assets or over debtor’s cash flow). A mortgage is straightforward, with the underlying collateral usually being the real estate used by the acquired entity to carry out its business, as this will compromise its activities in case of default and thus provides an incentive for the debtor to repay. The pledge of assets is very similar, with creditors usually requiring that the underlying collateral be the assets utilised for production. The resale value in case of foreclosure of the asset pledge can be tricky, as many assets can be hard to sell.

Another security used by lenders in certain transactions has been an assignment into a security trust of the target cash flows (i.e., assignment of receivables). In recent years, the use of this vehicle has increased drastically, mainly owing to the excessive onerousness and complex foreclosure of other types of securities. Under the security trust, the fiduciary title of certain assets (which can be any type of assets) is transferred to a trustee (who is to be determined by contract) so that he or she can liquidate these assets in order to satisfy a credit, subject to the occurrence of certain conditions, most commonly the default of the debtor.

Even though security trusts have been utilised in Argentina for many years, they were not expressly regulated until the last reform of the Argentine Civil and Commercial Code in August 2015. Prior to the enactment of this law, the National Supreme Court of Justice, in 2003, declared the security trust as valid. Nonetheless, the lack of express regulation generated a lot of discussion in the legal community over the scope of the security trust, primarily under scenarios of insolvency. Discussions have involved whether:

a a creditor would have to participate or not in a hypothetical bankruptcy or reorganisation proceeding of the debtor (since the assets are held in trust); or

b the need for a creditor guaranteed by a security trust to verify the credit under the bankruptcy or reorganisation proceeding of a debtor (as a creditor).

Also, there is certain case law in which the effects of a security trust over the debtor’s cash flow was terminated for the sole reason that without said flow the debtor will not be able to reorganise without this cash flow. This will not happen with a pledge or a mortgage.

Regrettably, the Argentine Civil and Commercial Code regulated the security trust, but omitted to address the above-mentioned issues, so the discussion persists.

One important guaranty that lenders should always try to get is personal guaranties from the owners. This is not easy to obtain, but generally in a stress scenario personal guaranties are a good leverage tool to renegotiate terms.

IV PRIORITY OF CLAIMS

Priorities in an insolvency procedure depend on the very nature of the existing debt. Privileges are ruled only by the Argentine Bankruptcy Law (ABL) and are detailed between Articles 239 and 250 of the ABL. Below is a chart describing priorities of claims.
<table>
<thead>
<tr>
<th>Type of credit</th>
<th>Description</th>
<th>Scope</th>
<th>Detail of the assets over which the privilege can be exercised</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses reserve</td>
<td>Expenses necessary for the bidding process of the bankruptcy assets</td>
<td>Expenses</td>
<td>Over the assets of the bidding</td>
</tr>
<tr>
<td>Special privilege</td>
<td>Construction, improvement and conservation of a thing or asset</td>
<td>Principal of credit</td>
<td>Over the thing, asset or subject of the improvement or construction (after paying 'expense reserve')</td>
</tr>
<tr>
<td></td>
<td>Credits for remuneration owed to an employee for six months, and those coming from severance payments, accidents, years of service or dismissal, lack of prior notice and the unemployment fund</td>
<td>Principal of credit plus interest for two years counting from the time of the due date</td>
<td>Over merchandise, raw materials and machinery that are property of the insolvent and are located in the establishment where services were rendered (after paying an 'expense reserve')</td>
</tr>
<tr>
<td></td>
<td>Taxes and fees applied over certain assets</td>
<td>Principal of credit</td>
<td>Over certain assets (after paying an 'expense reserve')</td>
</tr>
<tr>
<td></td>
<td>Mortgage, security interest</td>
<td>Principal of credit plus costs and interests for two years prior to the bankruptcy and compensatory interests after the bankruptcy until effective payment</td>
<td>Over the assets granted as subject matter of the relevant mortgage (after paying 'expense reserve')</td>
</tr>
<tr>
<td></td>
<td>Debts owed to the withholder for withholding certain things</td>
<td>Principal of credit</td>
<td>Over the retained thing (after paying an 'expense reserve')</td>
</tr>
<tr>
<td></td>
<td>Others (Article 241, Section 6), in other words, the Navigation Law or the Customs Code</td>
<td>Principal of credit</td>
<td>After paying an 'expense reserve'</td>
</tr>
<tr>
<td>Justice and conservation expenses</td>
<td>All expenses derived from the conservation of the assets</td>
<td>Expense</td>
<td>Over all assets (after paying an 'expense reserve')</td>
</tr>
<tr>
<td>General labour privilege</td>
<td>Credits for payments and family subsidies owed to workers for six months and those coming from severance, work-related accidents, years of service or dismissal, lack of prior notice, vacations, 13th salary, unemployment fund, and any other credit related to the employee–worker relationship</td>
<td>Principal of credit plus interests for two years from the due date and judicial expenses (if applicable)</td>
<td>Over all assets (after paying an 'expense reserve', 'special privilege' and 'conservation expenses')</td>
</tr>
<tr>
<td>General privilege</td>
<td>Payments owed to national, provincial or municipal social security organisms, family subsidies and unemployment fund</td>
<td>Principal of credit</td>
<td>50 per cent of all assets (after paying an 'expense reserve', 'special privilege', 'conservation expenses' and 'general labour privilege') (Article 247 ABL)</td>
</tr>
<tr>
<td></td>
<td>Taxes and fees owed to national, provincial or municipal tax organisms</td>
<td>Principal of credit</td>
<td>50 per cent of all assets (after paying an 'expense reserve', 'special privilege', 'conservation expenses' and 'general labour privilege') (Article 247 ABL)</td>
</tr>
<tr>
<td>Unsecured creditors</td>
<td>All credit without privilege</td>
<td>Capital and interests</td>
<td>50 per cent of all assets (after paying an 'expense reserve', 'special privilege', 'conservation expenses' and 'general labour privilege') (Article 247 ABL) and remaining assets (after paying the general privilege)</td>
</tr>
</tbody>
</table>
V  JURISDICTION

i  Choice of forum

The Civil and Commercial Code of Argentina allows the parties to an international agreement to select the jurisdiction of either an arbitration tribunal acting abroad or a foreign court, for the settlement of disputes that arise under such agreement. Furthermore, the courts of Argentina have exclusive jurisdiction over insolvency procedures related to debtors who are domiciled in Argentina. With regards to the right to be heard in court, the Constitution of Argentina grants unlimited access to all people, foreign or nationals to have their disputes resolved by a court of law. Argentine courts also recognise procedures of Argentine debtors that have taken place abroad as long as the foreign country recognises reciprocity.

ii  Enforcement of arbitration awards and foreign judgments

As a general principle, Argentine courts will recognise both arbitration awards rendered abroad and foreign judgments.

In the absence of a treaty for the enforcement of foreign judgments, the National Code of Civil and Commercial Procedure will be applied to the enforcement of foreign judgments if the matter at hand is decided before a federal court or if the defendant is domiciled in the City of Buenos Aires. In matters decided before provincial courts, provincial procedural rules will apply. Argentine courts will enforce foreign judgments subject to the fulfilment of the following requirements:

a  the judgment was final and issued by a competent court of law, according to Argentine conflict of laws principles regarding jurisdiction;

b  the judgment was valid in accordance with the law of the jurisdiction where it was rendered;

c  the defendant was personally summoned and granted due process, in accordance with Argentine legislation;

d  the judgment must not be in conflict with a prior or simultaneous judgment of an Argentine court; and

e  the judgment must not be contrary to any of the public policy principles of Argentine law.

Regarding arbitration proceedings, domestic awards may be enforced as any domestic court's final decision (through summary enforcement proceedings). As for foreign awards, international commercial arbitration is governed by the new International Commercial Arbitration Law, in force since August 2018, which mainly follows the guidelines of the UNCITRAL Model Law. Under the International Commercial Arbitration Law, an arbitral award, irrespective of the country in which it was made, shall be recognised as binding and, upon application in writing to the competent court, shall be enforced subject to the provisions of Sections 102 to 105.

However, recognition and enforcement of an arbitral award may be refused:

a  at the request of the party against whom it is invoked, if that party furnishes to the court proof that: (1) a party to the arbitration agreement was under some incapacity, or the agreement is not valid; (2) the party against whom the award is invoked was not given proper notice or was otherwise unable to present his or her case; (3) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration; (4) the arbitral procedure was not in accordance with the
argreement of the parties, or – failing agreement – was not in accordance with the law of the country where the arbitration took place; and (5) the award has not yet become binding or has been set aside or suspended; or

b. if the court finds that: (1) the subject-matter of the dispute is not capable of settlement by arbitration under Argentine law (under Section 1651 of the National Civil and Commercial Code, civil status or capacity of persons, family matters, consumers cases, adhesion contracts and labour disputes cannot be submitted to arbitration); or (2) the recognition or enforcement of the award would be contrary to public policy under Argentine law.

Furthermore, with regard to arbitration awards, and subject to Section 1656 of the National Civil and Commercial Code, parties cannot waive their right to judicially challenge an arbitral award when it is contrary to Argentine law. However, courts have reasonably come to construe that the extent of the waiver applies only to arbitration awards that violate public policy, deny due process, resolve matters not submitted to arbitration, or the award is rendered out of the term agreed for its issuance.

VI ACQUISITIONS OF PUBLIC COMPANIES

Public takeovers and mergers of listed companies are regulated by Law No. 26,831 (as regulated by Decree No. 1023/2013 and amended by the Productive Financing Law No. 27,440, among others) and the rules of the CNV – especially Resolution No. 779/2018 (the Resolution). Consequently, prior approval of the CNV, as enforcement authority, is required. Additionally, it may also be necessary to obtain approval from other governmental entities (for example, the Argentine Central Bank and the Anti-Trust Authority), depending on the circumstances involved and the business activities of the company.

Under Argentine legislation, a public takeover occurs when a human or legal person, acting individually or in concert, offers to acquire or exchange shares with voting rights of a listed company for a certain term under certain terms and conditions. The CNV has strongly regulated the scope of ‘acting in concert’ for the purpose of this definition.

Tender offers in Argentina may be classified under three different types: (1) the voluntary tender offer; (2) the ‘strictly speaking’ mandatory tender offer, that is required to be made by a person who reached a participation in the control of the target company, under the terms of the CNV Rules; and (3) the squeeze-out tender offer, triggered when a human or legal person, either directly or through another or other companies controlled by third parties, holds 95 per cent or more of the capital stock of the target company. Additionally, when a listed company is willing to delist, it is also mandatory to launch a tender offering.

According to the Resolution, no mandatory partial tender offer is required in the event of an acquisition of a significant participation in the capital stock of a listed target company, provided that it does not imply the acquisition of a controlling interest in the target company.

The participation in the control of the target company is basically met when: (1) the scope of the offering, directly or indirectly, reaches a number of shares that represents a percentage equal to or greater than 50 per cent of the shares with voting rights of the target company; or (2) the offeror holds a number of shares that represents less than 50 per cent of the shares with voting rights of the target company but acts as a controlling party in accordance with Law No. 27,440.
The voluntary tender offer may not aim to buy the total amount of outstanding shares of the target company and may not duly comply with the payment of an equal price per share for all the shareholders. However, in a mandatory tender offer, the offer to purchase must represent 100 per cent of the shares with voting rights, subscription rights, stock warrants or stock options, convertible securities or other similar instruments of the target company (regardless of the percentage of the shares that will actually be purchased at the end of the process) and must respect an equal price per share for all the shareholders. Several CNV rules establish the requirements for an equal price, which must be followed.

The CNV rules provide that a mandatory tender offer is required to be made by the party that has effectively reached the control of a target listed company: (1) through the voting shares, subscription rights, stock warrants or stock options, convertible securities or other similar instruments of the target company that are entitled to own or buy shares; (2) through agreements with other holders of securities that, in a concerted manner, ensure the necessary votes to form the corporate will in ordinary meetings or to elect or revoke the majority of the board members; and (3) indirectly or as a result of a corporate reorganisation process.

Before making a tender offer, it is advisable to enter into negotiations with the key shareholders of the target company, always in compliance with the target company’s by-laws and applicable regulations. Once the requirements for a mandatory tender offer have been complied or once it has been decided to formulate a voluntary tender offer, the target company must file with the CNV an announcement disclosing the main terms of the offer, the before mentioned agreements and the highest price of the shares during the 12 month-period prior to the offer, among other things.

In order to obtain said prior approval of the CNV it is necessary to file an application with a prospectus stating the main terms of the offer as well as certain financial and company information.

VII THE YEAR IN REVIEW

Due to political issues, the economic performance has suffered a severe recession coupled with an inflation rate that affected investment in the country.

As explained above, exchange control regulations were imposed with a view to stop the transfer of dollars out of the country and specially to gain stability on foreign exchange rate. The requirement of Central Bank authorisation to pay dividends will not help to bring foreign investment, based on past history. The current administration has said that these measures were temporary in order to stabilise the economy. It is expected that the new administration will continue this regime or even reinforce some of the restrictions.

It is worth mentioning the development of the judicial case, informally known as the ‘Notebook Scandal’, where the investigation has unveiled the participation of multiple business people and members of the previous administration in bribes and corruption in order to be appointed adjudicators of administrative contracts. The case continues to have a huge impact on the economic and political aspects of the country. If confirmed, it would imply the existence of a corrupt system in force during 12 years of government. For the first time, politicians and businessmen were imprisoned over a corruption scheme. In addition, the current administration was able to reduce the cost of public works significantly by changing suppliers and imposing more transparent procedures.
VIII OUTLOOK

Among the various drafts of laws or administrative regulations that could affect the leverage of M&A activity under discussion, the following can be mentioned:

a) CNV Resolution 742/2018, which will turn enforce the stated new regime implemented by Law No. 27,440;

b) the Asset Recovery Bill, which will facilitate the decommission of assets obtained illegally by means of corruption, narcotrafficking and money laundering. As of September 2018, the Asset Recovery Bill was approved by Argentina’s Lower House of Congress. If enacted into law, it would provide for an autonomous judicial action in order to confiscate any assets or proceeds that are a product directly or indirectly of illicit activity;

c) the Public Ethics Bill, which would effect several changes on the current system, and is aimed at preventing public officials from taking advantage of public office to make a profit personally or through family members; and

d) the bill to amend the National Civil and Commercial Procedural Code and the National Civil and Commercial Code, which will modify aspects of the arbitration agreement, particularly, aspects related to precautionary measures, review of arbitration awards and optional clauses.
Chapter 3

AUSTRALIA

John Schembri and David Kirkland

I OVERVIEW

Australia has a long history of merger and acquisition activity, and consequently, the debt financing of these acquisitions is a well-trodden path for lenders and borrowers alike. Traditionally, the senior debt financing of acquisitions in Australia has been the domain of the banks, international and domestic, with the local ‘Big Four’ banks often taking lead roles in relation to the arranging and underwriting of these facilities. However, consistent with the European experience, the market has recently borne witness to the emergence and proliferation of non-bank, institutional lenders.

Traditionally, an Australian acquisition finance package will feature an amortising term loan A, together with a bullet term loan B, to fund the acquisition of the target group. These facilities will generally be accompanied by a pari passu revolving facility that is designed to meet the target’s working capital or contingent instrument needs, or both, post-acquisition. Capital expenditure or acquisition facilities are often also included as required (generally on a committed basis). Subordinated debt provided by specialised institutions (usually in the form of mezzanine loans or local capital markets products) also often features where the acquisition is of a sufficient size. Recently, there has been a trend for mezzanine funding to be provided at a level above the bank group, being the holdco level. This enables sponsors and senior lenders to avoid much of the complexity that comes from having this subordinated debt provided at (or just above) the level of the senior debt. As a general rule, loan documentation in the Australian market is relatively standardised, thus enabling loans to be drafted, priced and syndicated to a wide pool of financiers.

From a market perspective, Australian syndicated lending has, on the whole, had a difficult first half to 2019 (year on year) with syndicated lending having decreased by 31 per cent over this period relative to the same period in 2018 (US$36.56 billion from 84 deals in the first half of 2019 down from US$53.31 billion from 116 deals in the first half of 2018). The fall is in stark contrast to the highs reached in 2018 where Australian syndicated lending reached US$95.53 billion from 203 transactions, a 14.1 per cent rise in volume from 2017.

1 John Schembri and David Kirkland are partners at Gilbert + Tobin. The authors would like to thank Alex Kauye, Anna Ryan, Charley Xu, Deborah Johns, Johnathon Geagea, Muhunthan Kanagaratnam, Peter Bowden and Tina Chen for their assistance with the preparation of this chapter.


The decrease is consistent with a global fall in syndicated lending volumes (a 29 per cent global decrease in volumes year on year) and can be attributed to the impact of various global economic headwinds and other macroeconomic factors.

These factors, together with a number of microeconomic factors, have placed downwards pressure on domestic interest rates. Consequently, we are now in an environment where people are becoming increasingly concerned about negative interest rates (similar to the experience in Japan in 2016). From a documentation perspective, this has led to a focus on interest rate floors in loan documentation both in the leveraged market and more generally.

Despite the poor start generally, M&A-related financing was supported by strong volumes in the first quarter of 2019 (volumes reached US$27.8 billion from 42 deals in the first quarter of 2019, up 72.2 per cent from US$16.14 billion via 28 deals closed in the same period the year prior). This trend supports the view that Australia remains a favourable jurisdiction for international dealmakers seeking opportunities in the Asia-Pacific given its status as a mature economy with a sound legal system. It is expected that the current low interest rate environment will continue to draw M&A-related financing activity to the local market led strongly by service-based sectors.

Following a stellar 2017 and 2018 in which a string of substantial government privatisations took place (which included the privatisation of a majority stake in the WestConnex freeway project (A$9.26 billion), the New South Wales Land Registry Services (A$2.6 billion) and the Victorian Land Titles and Registry office (A$2.86 billion)), the first half of 2019 has seen a deceleration in the number of privatisations and new infrastructure projects. Despite the slowdown, asset privatisation remains an integral part of broader government strategy because it allows governments to unlock significant capacity within each respective state to invest into new transport and social infrastructure projects, which in turn, promises to generate additional deal flow.

Notable projects in 2019 include Queensland’s Cross River Rail, one of Queensland’s largest infrastructure projects in decades (A$5.4 billion) and the partial privatisation of Western Australia’s land titles services (A$1.41 billion).

Renewable energy project financings are expected to continue to drive growth in the utilities sector with recent notable transactions including the Finley Solar Farm’s A$250 million project financing and the Bango wind farm securing A$250 million in project financing.

Growth in the Australian unitranche (a hybrid loan that rolls senior and subordinated debt into a single debt instrument) market has also continued, with the popularity of these facilities reflecting that they are nimble and relatively easy to execute. A notable example of this trend is reflected with TPG Capital’s A$660 million financing in early 2019, which was the largest syndicated unitranche transaction ever closed in Australia.

In addition to the institutional lenders, foreign banks have a growing appetite for funding investments into Australian industries. This is demonstrated by Bank of China taking the top spot for most mandated arranger roles in Australian syndicated loans for the first half of 2019.  

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4 Source: Debtwire, Asia Pacific (ex-Japan) Loans League Table Report 1H19.
6 Source: Debtwire, Asia Pacific (ex-Japan) Loans League Table Report 1H19.
II REGULATORY AND TAX MATTERS

i Regulation of foreign investments in Australia

The Australian Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and its associated regulations (administered by the Foreign Investment Review Board (FIRB)) regulate the making of investments by foreign persons in Australian companies and assets (and in some cases offshore companies with the requisite Australian connection).

Under FATA, a ‘significant action’ is one that the Commonwealth Treasurer has the power to block or unwind (or impose conditions about the way in which it will be implemented) if he or she considers the transaction to be contrary to the national interest. Notifying a significant action and obtaining a statement of no objection cuts off this power. A subset of significant actions called ‘notifiable actions’ must be notified – failure to do so is an offence under the law.

One common type of notifiable action is where a foreign investor is looking to acquire a ‘substantial interest’ being 20 per cent or more of an Australian entity with total assets of more than A$266 million (indexed annually). Separate value thresholds apply for these kinds of acquisitions by non-government investors based in certain treaty countries, which currently includes Canada, Chile, Japan, Mexico, New Zealand, Singapore, South Korea, the United States and Vietnam (and will include any country for which TPP-11 comes into force) (currently A$1.154 billion (indexed annually) for acquisitions in non-sensitive businesses8). Treaty thresholds are generally not available if bidcos in non-treaty jurisdictions (including Australia) are used.

Another common notifiable action is where a ‘foreign government investor’ (defined as an entity that is at least 20 per cent owned by foreign governments, their agencies or instrumentalities or other foreign government investors from one country, or at least 40 per cent owned by foreign governments, their agencies or instrumentalities or other foreign government investors from multiple countries) is seeking to obtain an interest (directly or indirectly) of 10 per cent or more in an Australian entity or business (5 per cent if the acquirer has entered into a legal arrangement relating to its business and the Australian entity or business and any percentage if the acquirer is in a position to influence or participate in the central management and control of, or the policy of, the Australian entity or business (such as appointing a director)). This typically affects state-owned enterprises, sovereign wealth funds and public pension funds, or investment funds where these kinds of entities are investors. It is also important to note that (contrary to the statutory regime applying to most investors) an offshore transaction in which the acquirer is a foreign government investor can be caught as a notifiable action if the foreign target has any Australian business (other than where the value of the Australian assets is worth less than A$55 million, these assets constitute less than 5 per cent of the target’s global assets and none of these assets are used in a sensitive business).

Other notifiable actions include an acquisition of Australian land above the relevant threshold (the threshold varies depending on who the acquirer is and the type of land being acquired, noting that foreign government investors, vacant commercial land and residential land all have A$0 thresholds); an acquisition of (generally) 10 per cent or more of an

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8 Sensitive businesses include media; telecommunications; transport; defence and military related industries and activities; encryption and securities technologies and communications systems; the extraction of uranium or plutonium; or the operation of nuclear facilities.
Australian agribusiness with an investment value above A$58 million (indexed annually);\(^9\) an acquisition of at least 5 per cent of an Australian media business, regardless of value; an acquisition by a foreign government investor of a legal or equitable interest in a tenement; an acquisition by a foreign government investor of an interest of at least 10 per cent in the securities in a mining, production or exploration entity; and the starting of a new business in Australia by a foreign government investor.

Other kinds of transactions that are not notifiable actions may still be caught as ‘significant actions’. Although notification of these transactions is not mandatory, foreign investors frequently choose to notify these transactions and obtain approval in order to cut off the Commonwealth Treasurer’s powers. The most common transactions that are caught are purchases of Australian businesses (i.e., asset sales) with total assets of more than A$266 million (indexed annually) and offshore transactions where the foreign target has Australian assets (including shares in an Australian subsidiary) valued at more than A$266 million (indexed annually). Again, investors based in certain treaty countries are in some cases subject to different thresholds.

While FIRB approval is principally a matter of concern from an M&A perspective (where ownership in the shares or assets are actually being transferred), it is also relevant in a debt finance context given that ‘obtaining an interest’ also extends to the grant of a security interest over such shares or assets or the enforcement of such security.

In a finance context, there is an exception from this requirement if the interest is either held by way of a security or acquired by way of enforcement of a security, solely for the purpose of a money-lending agreement. This applies to persons whose ordinary business includes the lending of money (which is deliberately broad enough to capture institutions that are not authorised deposit-taking institutions (ADIs) and also captures a subsidiary or holding company of such a lender, a security trustee or agent, and a receiver or receiver and manager of an entity that holds or acquires the interest). This exception also applies to a ‘foreign government investor’, although in respect of an interest acquired by way of enforcement of a security, a foreign government investor is restricted in the amount of time it can hold an asset (12 months in the case of an ADI and six months in the case of a non-ADI, unless the foreign government investor is making a genuine attempt to sell the assets acquired by way of enforcement). It should be noted that the money-lending exception has more limited application where the security is over residential land.

Where the acquisition is not politically sensitive, these approvals are generally provided as a matter of course, although the need for FIRB approval should be considered where security is being granted over material Australian entities and the imposition of conditions around tax, data handling and the like is becoming routine.

It should also be noted that other government approvals can also be required to take security over certain types of assets (such as mining and resource interests) that are subject to separate regulation.

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\(^9\) Non-government investors from certain treaty countries are subject to different thresholds.
ii Interest withholding tax

Interest withholding tax (IWT) of 10 per cent applies on gross payments of interest (or payments in the nature of interest) made by Australian borrowers to non-resident lenders (except where the lender is acting through an Australian permanent establishment or where other exceptions apply). IWT is a final tax and can be reduced (including to zero) by domestic exemptions and the operation of Australia’s network of double tax agreements (DTAs).

Under DTAs with Finland, France, Germany, Japan, New Zealand, Norway, South Africa, Switzerland, the United Kingdom and the United States, there is no IWT for interest derived by a financial institution unrelated to the borrower (subject to certain exceptions).

Under Australian domestic law, IWT may also be exempt where the debt satisfies the ‘public offer’ exemption (contained in Section 128F of the Income Tax Assessment Act 1936 (Cth)). Once the debt satisfies the public offer exemption, it is typically more marketable as an incoming lender remains entitled to the benefits of the exemption from IWT (subject to certain criteria being met). Broadly, the public offer exemption applies where an Australian company publicly offers debt via one of several prescribed means, including (most commonly):

a the debt instrument is offered to at least 10 persons, each of whom is carrying on a business of providing finance, or investing or dealing in securities in the course of operating in financial markets, and is not known or suspected by the borrower to be associates of one another or of the borrower; or

b the debt instrument is offered to the public in electronic form that is used by financial markets for dealing in debentures or debt instruments.

Syndicated facility agreements can only satisfy the public offer exemption where the borrower or borrowers will have access to at least A$100 million at the time of the first loan (among other criteria).

An IWT exemption will not apply where the issuer (or arranger acting as agent for the issuer) knew or had reasonable grounds to suspect that the debt instrument will be acquired by an offshore associate of the Australian borrower, unless the associate acquired it in the capacity of a dealer, manager or underwriter.

IWT relief also applies to certain foreign pension funds and sovereign funds. Under new law the IWT exemption will only apply to foreign pension and sovereign funds with (broadly) portfolio-like interests, being interests in an entity that are less than 10 per cent of total ownership interests (on an associate-inclusive basis) and do not carry an ability to influence the entity’s decision-making. Additionally, under the new law the IWT exemption for sovereign funds will only be available for returns on investments in Australian companies and managed investment trusts.

iii Thin capitalisation

Australia has a thin-capitalisation regime that can operate to deny income tax deductions for interest expenditure on overly geared Australian groups that have debt deductions over the de minimis threshold of A$2 million for an income year. There are three methods to calculate the maximum allowable debt of a taxpayer. Most Australian borrowers will rely on the safe harbour, which in broad terms allows for Australian assets to be funded by up to 60 per cent debt. In the context of an acquisition, these provisions allow for the funding of acquired goodwill.

In addition, there is an arm’s-length debt test, which broadly allows Australian groups to be debt-funded up to the maximum amount a third-party lender would be willing to lend. Although this test has not typically been used (as it is an annual test, and, therefore, is
contingent on the prevailing debt markets year on year), taxpayers are increasingly adopting this approach. Another test, the worldwide gearing test, allows an entity to gear its Australian operations, in certain circumstances by reference to the level of its worldwide group.

III SECURITY AND GUARANTEES

i Common security packages

The Personal Property Securities Act 2009 (Cth) (PPSA) sets out the principles applicable to the grant and perfection of security interests in Australia, principles that should be relatively familiar to anyone who has had experience in a common law jurisdiction.

The PPSA introduced a uniform concept of a ‘security interest’ to cover all existing concepts of security interests, including certain mortgages, charges, pledges and liens. It applies primarily to security interests in personal property that arise from a consensual transaction that, in substance, secures payment or performance of an obligation. It also applies to certain categories of deemed security interests, so that like transactions will be treated alike. ‘Personal property’ is broadly defined and essentially includes all property other than land, fixtures and buildings attached to land, water rights and certain statutory licences.

In a typical domestic secured lending scenario, security is most commonly taken by the relevant security providers entering into a general security deed which covers all of the relevant security providers’ assets and undertakings (the local equivalent of a debenture). Such an instrument can attach to all forms of ‘personal property’ (both tangible and intangible) and operates in a similar way to a debenture or security agreement. Accordingly, all-asset security can be obtained from corporate grantors simply and effectively.

In an acquisition context, the general security deed is often supplemented, where necessary, by a specific security deed over the shares of an Australian target (i.e., a share mortgage) granted by its special purpose vehicle or offshore parent. This is often a necessary part of the security structuring where restrictions on the provision of financial assistance (dealt with further below) mean that direct target security cannot be obtained on closing the acquisition. In each case, these security interests are supported by corporate guarantees, which are typically documented in the credit agreement.

To ensure priority and perfection, each of these security interests must be registered on the Personal Property Securities Register (PPSR), created under the PPSA, within 20 business days of the security agreement that gave rise to the security interest coming into force. While not mandatory, registration will generally ensure that the security interest retains its priority against subsequently registered interests and that it remains effective in the event of the insolvency of a corporate security provider. It is possible (and advisable) for lenders to search the PPSR to determine whether there are any prior security interests registered against the relevant entities in the structure (including the Australian-domiciled holding companies and targets, together with any offshore parents of these entities).

Security can be granted over real property (both freehold and leasehold) by way of a registered real property mortgage. Such security is only generally sought where the real property in question has operational or economic significance. Unlike security interests that are dealt with under the PPSA, the grant of security over real property is dealt with on a state-by-state basis. However, from a practical perspective, there are few fundamental differences between the regimes in the various states. As with personal property and PPSR searches, the relevant land registries can, and should, be searched to determine what encumbrances or restrictions on title have been registered against the relevant property.
ii  Issues with the grant of security

**Financial assistance**

Section 260A of the Corporations Act 2001 (Cth) (Corporations Act) imposes restrictions on a company providing financial assistance for the acquisition of its, or its holding companies’, shares. Financial assistance includes not only the granting of security, but also the provision of guarantees and indemnities (among other things). While a transaction that breaches this restriction is not invalid, any person involved in the contravention of this provision may be found guilty of a civil offence and subject to civil penalties. This liability can be criminal where a person is dishonestly involved in a breach. This liability (both civil and criminal) can theoretically extend to the lenders.

The general prohibition on the provision of financial assistance is subject to certain exceptions. The most commonly utilised exception is the exception set out in Section 260A(1)(b) of the Corporations Act (colloquially known as the ‘whitewash’ process), which enables the shareholders of the company to approve the proposed financial assistance. Given that an acquisition financing will invariably involve the grant of target security, the financial assistance rules are particularly relevant to this form of financing. For this reason, security over Australian target entities is generally granted within an agreed period post-closing (typically no less than 30 days) following the completion of ‘whitewash’. That said, this restriction does not impact the grant of security by any Australian incorporated special purpose holding company, or any offshore parent over its shares in an Australian-domiciled entity, which can be provided in a more timely fashion.

**Corporate benefit**

Under Australian law, directors owe a number of duties to the companies to which they have been appointed. These duties are enshrined in the Corporations Act, as well as arising under general law, and include a fiduciary duty to act in good faith in the best interests of the company. In a secured lending context, these duties often come under scrutiny in circumstances where a subsidiary is asked to guarantee the debts of its parent or sister companies within the same corporate group. Where the party obtaining the benefit of a guarantee or security knows or ought to know that the directors have not acted in the best interests of the company in providing such credit support, the guarantee or security will be voidable against that party. For wholly-owned subsidiaries which are considering guaranteeing the debt obligations of their parent, the above duties are often viewed in light of Section 187 of the Corporations Act, which enables a wholly-owned subsidiary to adopt a provision in its constitution enabling it to act in the best interests of its holding company (and in so doing, will be deemed to be acting in the best interests of the company itself). Where Section 187 of the Corporations Act is not available, care should be exercised to ensure that the corporate security provider derives some benefit from granting the guarantee or security and that granting the guarantee or security is in the best interests of the corporate security provider.

A guarantee or security could be set aside by a court if that court finds that the directors of the security provider have breached their duties and the lender was aware of that breach.

**Administration risk**

‘Administration risk’ describes the risk for a secured party that its security becomes subject to a moratorium if an administrator is appointed to a corporate security provider (which the directors of that entity are likely to do if the company is or is likely to become insolvent).
Subject to the consent of the administrator or court order, a secured party is not entitled to enforce its security during the moratorium. This will be the case unless one of the exceptions apply, with the key exception being where the secured party has taken security over all, or substantially all, of the company’s assets and the secured party has enforced its security interest within the ‘decision period’. The ‘decision period’ runs for 13 business days from the date the secured party was given notice of the appointment of an administrator or the date that the administration begins.

Due to the above, a secured party who holds perfected security over only certain assets (and those assets alone do not comprise all, or substantially all, of the company’s assets) then that secured party will not be able to enforce its security during the moratorium. To address this risk where the primary collateral is limited to specific assets, a ‘featherweight’ security interest may be taken over all of the grantor’s assets (other than the principal secured property) that secures a nominal sum.

**Stamp duty**

Mortgage duty is no longer payable in any Australian jurisdiction.

iii  **Australian insolvency regime and its impact on the grant of security**

The Australian insolvency regime is codified in the Corporations Act and its associated regulations, and contains a number of provisions that can potentially affect the rights of a creditor of an Australian entity.

Under Australian law, transactions will only be vulnerable to challenge when a company does, in fact, enter into liquidation. Division 2 of Part 5.7B of the Corporations Act provides that a liquidator can bring an application to the court to declare certain transactions void. While an administrator is required, in its statutory report to creditors, to identify potential voidable transactions that may be recoverable by liquidator (if appointed), the administrator does not have standing to challenge these transactions.

There are several types of transactions that can be found to be voidable:

a  unreasonable director-related transactions;

b  unfair preferences;

c  uncommercial transactions;

d  transactions entered into to defeat, delay or interfere with the rights of any or all creditors on a winding up; and

e  unfair loans.

Transactions in categories (b), (c) and (d) will only be voidable where they are also found to be ‘insolvent transactions’; that is, transactions that occurred while the company was insolvent under Australian law, or contributed to the company becoming insolvent.

Each type of voidable transaction has different criteria and must have occurred during certain time periods prior to administration or liquidation. The relevant time periods are generally longer if the transaction involves a related party.

An unfair preference arises in circumstances where an unsecured creditor receives an amount greater than would have been received if the creditor had been required to prove for it in the winding-up of the relevant company, whereas transactions have been held to be ‘uncommercial’ where an objective bystander in the company’s circumstances would not have entered into it.
In addition, the court has the power to determine a loan to be ‘unfair’ (and, therefore, voidable) if the terms of the loan (specifically the interest and charges) could not be considered to be commercially reasonable (i.e., they are ‘extortionate’). In practice, this provision has been seldom used, and the courts in Australia are reluctant to intervene unless the commercial terms greatly deviate from typical market terms (taking into account the financial situation of the company).

Upon the finding of a voidable transaction a court may make a number of orders, including orders directing a person to transfer the property that was the subject of the impugned transaction back to the company in liquidation and orders directing a person to pay to the company in liquidation an amount that fairly represents the benefit received under the impugned transaction.

iv Recent reforms to the Australian insolvency regime

With effect from 1 July 2018, reforms to the Australian insolvency regime impose an automatic stay on the enforcement of *ipso facto* clauses in certain contracts entered into on or after that date.

The automatic stay will apply where one of the following insolvency events occurs in relation to a company:

a. voluntary administration;

b. a receiver or controller is appointed over the whole or substantially the whole of the company’s assets;

c. the company announces, applies for or becomes subject to a scheme of arrangement in order to avoid a winding up; or

d. the appointment of a liquidator immediately following an administration or a scheme of arrangement.

The automatic stay will not apply retrospectively (i.e., for agreements entered into prior to the new provisions coming into force). Relevantly, the automatic stay does not apply to other types of contractual defaults – for example, if the company has failed to meet its payment or other performance obligations under the relevant agreement.

The length of the automatic stay depends on which formal insolvency process applies to the company as follows (subject to a court order extending the stay):

a. scheme of arrangement: the stay will end within three months of the announcement, or where an application is made within that three months, when the application is withdrawn or dismissed by the court or when the scheme ends or the company is wound up;

b. receivership or managing controllership: the stay will end when the receiver’s or managing controller’s control ends; and

c. voluntary administration: the stay will end on the later of when the administration ends or the company is wound up.\(^\text{12}\)

\(^{10}\) These changes were introduced by the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth) and are reflected in the Corporations Act 2001 (Cth).

\(^{11}\) An *ipso facto* clause is a contractual clause that allows one party to enforce a contractual right, or terminate a contract, upon the occurrence of a particular event; usually upon insolvency or a formal insolvency appointment (for example, the appointment of a voluntary administrator).

\(^{12}\) See Sections 415D(2)–(3), 434J(2)–(3) and 451E(2)–(3) of the Corporations Act 2001 (Cth).
Importantly, the automatic stay does not apply once, or if, a company executes a deed of company arrangement (DOCA). The automatic stay ends when the ‘administration ends’, that is when a DOCA is executed by the company and the deed administrator. Accordingly, if a company does execute a DOCA and needs the protection of the automatic stay, then subject to limited exceptions, it will need to obtain court orders.

The scope of the automatic stay, specifically what contract types, rights and self-executing provisions are excluded by the automatic stay are set out in the legislation. Relevantly, syndicated loans (and derivatives) are excluded from the operation of the automatic stay, and rights under those contracts will remain available to the parties should a trigger event occur. Accordingly, the impact of these changes on acquisition financings (which contemplate a customary security package) is likely to be minimal.

By contract, bilateral facility agreements are not excluded under the relevant legislation and as such the automatic stay provisions will apply to agreements entered into after 1 July 2018. The APLMA (Asia Pacific Loan Market Association) has issued a recommended rider clause for lenders to include in bilateral facility agreements to assist a lender in accelerating the loan as against a guarantor of that facility where the borrower is subject to a relevant insolvency process. It is important to note that this right to accelerate the loan as against the guarantor will not operate where the guarantor itself is also the subject of a relevant insolvency process under the Corporations Act.

In addition, it is worth noting that the automatic stay does not prevent secured creditors from appointing a receiver during the decision period pursuant to Section 441A of the Corporations Act (if they have security over the whole or substantially the whole of the company’s property) or enforcing security interests over perishable goods or prevent secured creditors or receivers from continuing enforcement action that commenced before the administration.

As the automatic stay provisions only came into operation from 1 July 2018 (and the provisions only apply to certain contracts entered into after that date), there has not yet been any judicial consideration of these provisions.

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13 These are contained in the Corporations (Stay on Enforcing Certain Rights) Regulations 2018 (the Regulations) and the Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (the Declaration). The Regulations prescribe 42 types of contracts, agreements or arrangements that are excluded from the operation of the automatic stay, and rights in those kinds of arrangements remain available to the parties to those arrangements should a trigger event occur. Among the agreement types listed under the Regulations are, but are not limited to: (1) contracts, agreements or arrangements that are a licence or permit issued by federal, state or local government; (2) contracts, agreements or arrangements that are or are directly connected with derivatives and securities financing transactions; (3) contracts, agreements or arrangements for the underwriting of an issue or sale of, or under which a party is or may be liable to subscribe for securities, financial products, bonds, promissory notes or syndicated loans; and (4) contracts, agreement or arrangements that are or govern securities, financial products, bonds, promissory notes or syndicated loans. The Declaration declares 11 kinds of rights (including self-executing clauses that, when executed, provide those rights) as excluded from the operation of the automatic stay and those rights remain available to the parties should a trigger event occur. By way of illustration only, the kinds of rights excluded by the Declaration include, but are not limited to a right: (1) to terminate under a standstill or forbearance arrangement; (2) to change the priority in which amounts are to be paid under a contract, agreement or arrangement; and (3) of set off, combination of accounts or to net balances or other amounts.
IV  PRIORITY OF CLAIMS

i  Priority of claims on insolvency

Generally, unsecured claims in Australia will rank equally on a pari passu basis. Section 555 of the Corporations Act provides that, unless the Corporations Act provides otherwise, all debts and claims in a winding-up rank equally, and if the property of the company is insufficient to meet them in full, these claims will be paid proportionately.

There are a number of exceptions to this general proposition (see Section 556 of the Corporations Act), including:

a expenses properly incurred by a liquidator or administrator in preserving or realising property of the company, or in carrying on the company’s business (as well as other costs and amounts owed to them); and

b employee entitlements.

Sitting outside this regime are secured creditors, who will have priority over unsecured creditors. The security granted in their favour will entitle them to priority for payment of amounts outstanding from the proceeds and realisations of assets subject to such security interests. There is one exception to this, which is that employee entitlements have a statutory priority to the proceeds of assets subject to a circulating security interest (formerly, a floating charge) on realisation by a receiver or liquidator to the extent that the property of the company is insufficient to meet these amounts.

ii  Subordination and the enforceability of intercreditor arrangements

Contractual subordination is a well-accepted tenet of secured lending in Australia; accordingly, intercreditor arrangements are commonly used in Australia to contractually clarify the relationship between two or more classes of creditor (including shareholder lenders and hedging counterparties).

Structural subordination is, however, less common (with a notable exception for holdco payment-in-kind instruments, which have been gaining popularity in recent times). Accordingly, second-lien structures are able to be accommodated relatively easily from a local perspective, as demonstrated by the second-lien facility in the recent DTZ acquisition financing (and subsequent increments) where the contractual subordination was documented via a New York law-governed intercreditor arrangement.

Unlike that contained in the Loan Market Association suite of documents, there is currently no market standard intercreditor in Australia. A set of intercreditor principles (primarily applicable to leveraged transactions) has been circulated within the market, although they have not been universally adopted. Accordingly, a number of the provisions that these principles attempted to standardise (e.g., drag rights, standstill periods, mezzanine information rights and release provisions) remain hotly contested.

V  JURISDICTION

i  Consent to jurisdiction

Australian courts will generally respect the submission of an Australian entity to the courts of another jurisdiction, provided the choice of jurisdiction was not entirely unconnected with the commercial realities of the proposed transaction (and that there are no public policy reasons to deny such a submission).
Enforceability of foreign judgments

In Australia, the enforcement of civil judgments obtained in foreign courts is generally covered by two regimes. The first is under the Foreign Judgments Act 1991 (Cth) (FJA), which applies to certain specified courts in prescribed jurisdictions. Where the relevant court is not prescribed by the FJA, the enforceability of the relevant judgment will be dealt with by common law principles.

The FJA provides a framework, based on registration, for civil judgments made in prescribed foreign courts to be enforceable in Australia. This regime applies to judgments made by certain courts in prescribed jurisdictions, for example, certain Swiss, French, Italian, German and UK courts. Under the FJA, a judgment creditor of a relevant foreign judgment may apply to an Australian court for that judgment to be registered any time within six years of the last judgment in the foreign court. The judgment may be registered if it is final and conclusive for a fixed sum of money (not being in respect of taxes, a fine or other penalty), and is enforceable by execution in the relevant foreign country. Registration gives the judgment the same force and effect as if the judgment originally had been given in the Australian registering court (subject to certain exceptions). Special rules are also applicable to the enforceability of New Zealand judgments. The registration may be set aside if the foreign court did not have the necessary jurisdiction over the judgment debtor, either because the judgment debtor did not reside or carry on business in the jurisdiction when the proceedings were brought or did not otherwise submit to the jurisdiction of the court.

However, in certain jurisdictions (such as the United States) where Australia does not have the benefit of a treaty that provides for the reciprocal recognition and enforcement of judgments in civil matters, there is no statutory recognition or statutory enforcement in Australia of any judgment obtained in a court in such a jurisdiction. Instead, a judgment made by a court of the relevant jurisdiction can only be enforced in Australia under the common law regime.

Under that regime, any final, conclusive and unsatisfied judgment of the relevant court that has the necessary jurisdiction over the judgment debtor that is in personam (that is, it imposes a personal obligation on the defendant) and is for a definite sum of money (not being a sum in respect of taxes or other charges of a like nature or in respect of a fine or other penalty) will be enforceable by the judgment creditor against the judgment debtor by action in the Australian courts (without re-examination of the merits of the issues determined by the proceedings in the relevant court). There are some exceptions, including where the proceedings involved a denial of the principles of natural justice, or the judgment was obtained by fraud or some other vitiating factor.

In seeking to enforce a foreign judgment under either regime, a practical difficulty often encountered if the foreign proceeding was not defended is proving that the foreign court has the necessary jurisdiction over the judgment debtor. Where the debtor is a corporation, the applicant will need to show that the debtor carried on business within the jurisdiction of the foreign court, either by maintaining a branch office or by employing an agent with the authority to bind the company and to conduct business there on its behalf.

In respect of recognition of foreign insolvency judgments, Australia has enacted the UNCITRAL Model Law on Cross-Border Insolvency in the Cross-Border Insolvency Act 2008 (Cth). Australian courts recognise the jurisdiction of the relevant foreign court in which the ‘centre of main interest’ is located and generally cooperate with foreign courts and insolvency practitioners.
VI ACQUISITIONS OF PUBLIC COMPANIES

The Australian corporations legislation (the Corporations Act) limits the manner in which a person can acquire voting securities in a listed Australian company or managed investment scheme, or an unlisted Australian company or managed investment scheme with more than 50 members, where this would cause that person’s (or someone else’s) voting power in the relevant entity to increase above 20 per cent or to increase (by any amount) from a starting point between 20 per cent and 90 per cent. There are two principal methods of acquiring control of an Australian publicly listed company or managed investment scheme: takeover bids or schemes of arrangement.

While there is no strict legal requirement for ‘certain funds’ financing, from a practical perspective, and owing to the increasing sophistication of both borrowers and lenders, financiers’ commitments to fund are often provided on this basis (and indeed, this is desirable from an acquirer’s perspective).

i Takeover bids

Chapter 6 of the Corporations Act provides the framework for takeover bids under Australian law. A takeover bid can be made on-market or off-market, and does not require the support of the target (i.e., a bid can be made on a ‘hostile’ or ‘friendly’ basis). For both on-market and off-market bids, a bidder must prepare and send to the target security holders a document (known as a ‘bidder’s statement’) that includes details of the offer, information about the bidder and certain other prescribed information (e.g., in relation to the bidder’s intentions). The target must respond by preparing and issuing a ‘target’s statement’ including the target board’s recommendation as to whether security holders should accept the offer, as well as any other material information.

An on-market bid is made through a broker and can only be used to acquire securities in a listed entity. On-market bids are far less common than off-market bids because they require the consideration to be 100 per cent cash and, importantly, cannot be subject to any conditions. Accordingly, it will often be the case that an on-market bid is not a viable option, for example, because the bidder requires regulatory approvals or other conditionality, or because the bidder’s financing arrangements require security to be taken over the target’s assets (which can only be assured in a 100 per cent ownership scenario).

An off-market bid essentially takes the form of a written offer to security holders to purchase all or a specified proportion of their securities. The consideration can take the form of cash, securities or a combination of the two. The offer must be open for acceptance for a period of not less than one month and not more than 12 months. All offers made under an off-market bid must be the same.

An off-market bid may be subject to any conditions the bidder chooses, other than conditions that are solely within the control of the bidder (or turn on the bidder’s state of mind) and certain other prohibited conditions.

Typical conditions include those relating to the non-occurrence of certain statutorily prescribed events (including certain insolvency type events), the non-occurrence of a material adverse effect, the obtaining of any necessary regulatory approvals, the absence of any legal restraints or prohibitions to the acquisition completing, and the receipt of a minimum number of acceptances (usually 50 or 90 per cent, the latter corresponding to the threshold for the compulsory acquisition (or ‘squeeze-out’) of minorities).
Unlike the position in the United Kingdom, there is no legal requirement in Australia for ‘certain funds’ financing. However, the Corporations Act does prohibit persons from making an offer if they are unable, or are reckless as to whether they are able, to complete the offer. The Australian Takeovers Panel has separately indicated that it expects that where the bid is debt-funded, a bidder would have binding commitments from its lenders at the time of announcing its offer and would not declare its bid unconditional unless it is highly confident that it can draw down on these facilities (i.e., binding funding arrangements are documented in final form and commercially significant conditions precedent to draw down have been satisfied or there is no material risk such conditions precedent will not be satisfied).  

ii Schemes of arrangement

A scheme of arrangement is a court-approved arrangement entered into between a body (i.e., the target) and all, or a class, of its members. For a scheme to become binding on the target and its members (or the relevant class thereof), it must be approved by more than 50 per cent of members who vote on the scheme and those members must represent at least 75 per cent of the votes cast on the scheme. If these thresholds are met, the scheme is binding on all members (or all members in the relevant class), including those who vote against the scheme or do not vote at all. The test for identifying classes for the purposes of a scheme is that a class should include those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to a ‘common interest’. However, the recent decision in In the matter of Boart Longyear Limited (No. 2) [2017] NSWSC 1105, suggests that courts may be willing to stretch the boundaries of what would ordinarily be considered to be the composition of a class and, in doing so, may agree to put persons in the same class even where such persons appear to have objectively distinct interests.

The typical operation of a scheme in the context of a control transaction is for the scheme to effect the transfer of target securities to the offeror in exchange for a specified consideration.

The consideration under a scheme can be structured such that security holders receive cash, securities or a combination of the two. There is more flexibility under a scheme with respect to the structure of the consideration as, unlike in a takeover bid, it is not necessary for all offers under a scheme to be the same, more easily facilitating differential treatment of security holders. Schemes can also be used to implement corporate restructures, demergers and debt-for-equity transactions.

A scheme of arrangement is essentially a target-driven process, with the target preparing the necessary security holder materials and seeking the necessary orders from the court. As such, a scheme requires the support of the target’s directors and therefore is only a viable option in ‘friendly’ transactions.

There is no statutory requirement for ‘certain funds’; however, as part of the court process, the offeror will be required to satisfy the court that it has sufficient funds to pay the scheme consideration and consummate the transaction. On a practical level, and in addition to giving the target’s board comfort as to their ability to execute the transaction, this often results in offerors seeking certain funds funding from their financiers.

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14 Australian Takeovers Panel ‘Guidance Note 14 – Funding arrangements’.
As with ‘off-market’ bids, schemes can be subject to conditions, and it is common to see schemes being subject to the receipt of any necessary regulatory approvals, together with the non-occurrence of any material adverse effect with regards to the target. In addition, there are standard conditions relating to the necessary shareholder and court approvals.

VII THE YEAR IN REVIEW

See the first paragraph of Section I.i.

VIII OUTLOOK

While Australian syndicated lending has had a difficult start to 2019, activity within the acquisition and leveraged finance space is expected to continue to improve off the back of M&A activity, and we anticipate that the forces that will shape the next 12 months will continue to be market-orientated (rather than legislative).
I OVERVIEW

The acquisition and leveraged finance market in Austria still benefits from stable transaction activity. According to publicly available data, though the overall transaction volume in Austria declined by 12 per cent to approximately €4.5 billion in the first half of 2019, this decline was comparatively small compared to other M&A markets.

The overwhelming majority of transactions were again strategic transactions. Transactions by financial investors (private equity or venture capital) fell in the first half of 2019. Hence, private venture capital continues to play only a minor role in the Austrian transaction market.

The largest deal of the year to date with Austrian participation took place in the oil sector: OMV invested around €2.2 billion acquiring 15 per cent of a refinery hub with integrated petrochemicals of the Abu Dhabi Oil Refining Company. This was followed by the complete takeover of Galeria Karstadt Kaufhof by the Signa Group for around €900 million, with the closing of the transaction subject to approval by the competition authorities. Fellner Wratzfeld & Partners assisted with the €600 million acquisition of Kika/Leiner by the Signa Group in the course of the Steinhoff group restructuring. This transaction was a landmark transaction in terms of timing and involved the securing of thousands of jobs.

To pursue their growth Austrian investors increasingly focus on acquisitions outside Austria, with around €3.6 billion being invested. Germany continues to be the most attractive investment target for Austrian investors (and vice versa). The largest part of outbound investments is still made in Europe (the Americas with only 6 per cent, Australia with 4.5 per cent and the Middle East with 3 per cent are far off). Takeovers by German companies account for more than 30 per cent of all inbound transactions, followed by transactions from France, the US, Finland and Belgium.

From a market perspective, supply and demand regarding loan financing has been growing for years. However, lending companies, in particular credit institutions, are still in the process of implementing and complying with European (and Austrian) regulatory legislation (e.g., increased equity requirements and capital buffers depending on the particular credit institution’s profile).

Overall lending activity is dominated by the participation in Anglo-Saxon and German syndicated financing transactions. Deal activity in the Austrian law financing market seems to be growing, while deal volumes remain stable or below pre-crisis levels. Massive growth can...
be seen in deals involving low two-digit-million volumes focusing on mid-market companies. Moreover low interest rates have created a borrower-friendly environment; borrowers are seeking to refinance their existing debt on more favourable and commercially attractive terms.

II REGULATORY AND TAX MATTERS

i Licensing

In order to provide loan financing on a commercial level to companies in Austria, there are three possible options:

a. application for a banking licence: Obtaining a banking licence is a rather complicated procedure and demands in-depth preparation over a longer period of time. One of the legal requirements that has to be satisfied and is especially extensive is the creation of an appropriate business plan that is subject to review by the regulator;

b. it is legally possible for a credit institute of another EU Member State to establish a branch (the existing banking licence would need to be notified to the Austrian regulator); and

c. the most common approach for non-Austrian banks that want to become active in the lending business and wish to avoid establishing a permanent presence is utilising the EU freedom of service to render services in another EU Member State.

For non-banks it is possible to participate in the lending business only if this activity is exempted from the requirement to hold a banking licence (e.g., acquisition of loan portfolios by special securitisation purpose entities). According to Section 4(1) of the Austrian Banking Act, the banking licence has to be issued by the Austrian regulator (the Financial Market Authority) for lending business (i.e., the providing of financing to borrowers on a commercial basis). Notified licences of a credit institution domiciled in another European Economic Area (EEA) jurisdiction (based on the home Member State concept) will be held equivalent for this purpose.

The same applies for the acquisition of (loan) receivables on a commercial basis (i.e., factoring), which, in principle, prevents workaround structures, such as the disbursement of a loan by an Austrian ‘fronting bank’ and immediate acquisition of the loan by a foreign, non-licensed lender. Limited exceptions to this principle apply, inter alia, to insurance companies granting loans for the purpose of creating a reserved asset base regarding their insured persons or customers.

Crowdfunding has recently been regulated in statutory law and provides for exceptions from both the bank licence and capital markets prospectus requirements, if and to the extent that a financing does not exceed certain thresholds. On the other hand, blockchain technologies in financing seem to be gaining tremendous attraction but remain so far unregulated. The Austrian regulator, however – as is the case with the German BaFin – is in the course of discussing the setting up of regulations.

ii Taxes and duties

Generally, not subject to withholding tax are the repayments of principal amounts under loan transactions. Additionally, as a general rule, interest payments are not subject to withholding tax. Rather, these payments are taken into account for purposes of the (corporate) income tax of the lender.
Austria

There are numerous double taxation treaties in place between Austria and a large number of jurisdictions, which typically provide for withholding tax to be considered as a deductible or capable of being refunded, or both. If payment of interest is effected, however, to a non-Austrian lender then withholding tax in the amount of 35 per cent may apply.

A significant potential tax burden or risk has been removed from granting loans to Austrian borrowers because of the abolition of Austrian stamp duty on loans and credits, effective for loans and credits granted on or after 1 January 2011. Certain types of security arrangements (such as suretyships and assignments) would also be subject to stamp duty. There is an exception, however, for these transactions entered into for the purpose of securing loan obligations (which are, themselves, exempt from stamp duty).

Debt funding may be subject to Austrian stamp duty (applied at a rate of 0.8 per cent to be calculated on the basis of the consideration for the acquisition of the loan) if it is structured by way of the acquisition of loan receivables (on a commercial basis). Numerous workaround structures are available (such as offshore documentation, i.e., execution and permanent safekeeping of transaction documentation, certified copies, etc., outside of Austria and strict avoidance of creating ‘substitute documentation’) in those cases (which would not apply to the original provision of debt financing by way of disbursing a loan).

In February 2019, updated guidelines regarding the Austrian Stamp Duty Act were published in the interest of uniform procedure and interpretation. Over the past 10 years, there were numerous changes to the law, which led to uncertainty in many areas. The guidelines have been revised, with all provisions which were no longer valid being deleted and new legal provisions being incorporated. The significant changes related to the comprehensive exemption of stamp duty for publications and certificates drawn up and issued on the basis of the Austrian Trade Regulations as well as entries relating to the drawing up and issuing of documents on the basis of the Austrian Stamp Duty Act. In addition, due to precedents set down by the Administrative Court and the Federal Fiscal Court, the assessment of options has been amended.

Interest charged to customers (borrowers) is not subject to regulatory limitations. However, there are certain basic limitations under Austrian civil law. Usury and potentially criminal law sanctions (for instance, fraud) are prohibited. There is a requirement, however, that the interest (agreements) may only then be considered prohibited and unenforceable if and to the extent that the agreed interest rate is clearly disproportionate to market terms and conditions and an agreement to that effect could only be reached (on record) because of the weakness, predicament or inexperience of the borrower. In the retail segment (consumer loans), various information duties and formal requirements apply. In commercial lending, relevant examples are hardly existent or relevant.

III SECURITY AND GUARANTEES

i General

In Austria, there are two general groups of collateral that may be used to secure lending obligations: personal collateral and in rem collateral. The following types of personal collateral for securing lending obligations are the most common: (1) assumption of debt; (2) sureties; (3) guarantees; and (4) letters of comfort.

Most common types of in rem collateral are: (1) pledge of assets (such as a pledge on movables or a mortgage); (2) transfer of title for security purposes; (3) assignment for security purposes; and (4) retention of title.
The most common types of collateral in lending transactions are share pledges, mortgages, account pledges, assignment of current and future receivables, trademark and IP right pledges, and sometimes the pledge of stock in warehouses (which, based on the very stringent law on perfection, basically requires that the pledgee takes control over the stock, hence making it extremely difficult to establish and maintain under Austrian law).

ii Limitations

Downstream guarantees (or other security) are not restricted by Austrian law. Stringent limitations apply, however, to upstream and side-stream guarantees provided by corporations (and equivalent entities).

In principle, distributions to (direct or indirect) shareholders of a corporation (AG, GmbH, GmbH & Co KG, i.e., a limited partnership in which the only unlimited partner is a GmbH) may only be effected under specific circumstances, namely (1) in the form of formal dividend distributions based on a shareholders’ resolution; (2) in the case of a capital decrease (which also requires a shareholders’ resolution); or (3) in the form of a distribution of liquidation surplus. In addition, it is recognised that a company and its shareholders may enter into transactions with each other on arm’s-length terms and conditions. This requirement entails that the management of the company makes – prior to entering into such a transaction – a comprehensive assessment of a proposed transaction, in particular of the risks involved, and shall only enter into such transactions with its (direct or indirect shareholder or a sister company) if and to the extent that it would enter into the transaction on identical terms and conditions with an unrelated third party. However, the management must not enter into a transaction, if by any such transaction the existence of the company would be threatened.

To some extent, Austrian case law also accepts specific corporate benefits as an adequate means of justification for granting upstream and side-stream guarantees. This corporate benefit cannot be disproportionate to the risk and must be specific and not only a general corporate benefit, such as a general ‘group benefit’. Austrian case law on these restrictions is based on a case-by-case evaluation and has become increasingly stringent over the past two decades. In practice, it is advisable to have the management of the company assess the proposed transaction in accordance with the above criteria.

Also, the Austrian courts impose very strict criteria on the permissibility of loans of a company to its shareholders and affiliated companies within the framework of the Austrian capital maintenance rules. Recently, the Austrian Supreme Court ruled that the classic third party comparison for transactions is not a suitable criterion for transactions of clearing companies, whose role is the financing and the forwarding of financial resources within the group. This is due to the fact that non-affiliated companies are not allowed to conclude these transactions. The courts considered which yardstick could be applied to measure these transactions of clearing companies. The court held that even though the clearing companies functioned in many ways like a bank, a comparison was not possible, because banks have different risk structures. Instead, the court applied the yardstick of a prudent businessman in determining whether the lending is lawful. Also the business purposes of the company and its corporate purpose help to determine the duty of care in determining whether the loans were justifiable. Potential consequences of breach of these Austrian capital maintenance rules include personal liability, potential criminal liability of the management as well as nullity of the respective transaction.
iii Roles of an agent or trustee

Under Austrian law accessory collateral such as sureties or pledges, will cease if it becomes separated from the underlying secured obligation. The concept of ‘security trustees’ or ‘agents’, as well as a generic type of ‘parallel debt’ is not recognised to validly establish collateral for one ‘security agent’, which is not at the same time a lender or not a lender in respect of all obligations that shall be secured by the (accessory) collateral. Austrian market practice in order to ensure that the characteristic ‘accessory’ is fulfilled either provides that all secured parties are at the same time pledgees (or direct beneficiaries) under the security agreements or that a ‘security agent’ is appointed, whereby it is agreed among all lenders with the consent of the borrower (or other obligors) that the security agent is the joint and several creditor of all claims, with it being further agreed among all creditors that only the security agent shall (following a decision process among all lenders) have the right to enforce the collateral and will then distribute the proceeds from this enforcement amongst all lenders in proportion to their exposure under the secured obligations.

As regards validity of non-accessory collateral (e.g., guarantees), it is not required that they are directly connected with the secured obligation. It is market practice to provide for joint and several creditorship if the lenders desire to execute their rights arising from the collateral via one security agent because loan documentation typically includes accessory and non-accessory collateral.

iv Collateral security over real property

Real property can be a security in the form of a pledge (mortgage). The pledge must be agreed upon between the pledgor and the pledgee. Though the pledge agreement does not require a specific form, for perfection it needs to be registered in the land register where the real property that is being pledged is located. In order to accomplish the entry into the land register, the pledgor of the property must provide a specific consent declaration in authenticated form regarding the registration. Multiple pledges over one individual property are possible. These will be ranked towards each other in terms of priority (the point in time when the application for registration of the pledge in the land register reaches the competent land register is decisive). It is possible to establish a mortgage over more than one property by creating a simultaneous mortgage.²

Registration fees amount to 1.2 per cent of the secured amount of the real property. That is why they play a significant role in the registration of a pledge over real property in the land register. In some lending scenarios, it is possible to avoid these fees. In these instances, the lender agrees to receive a registrable (i.e., authenticated) pledge agreement in combination with a ranking, which ensures for one year that no third party may enter another mortgage into the specific rank (which, however, owing to the limited time of the ranking order, the 0.6 per cent fee of the secured amount associated with the entry of the ranking order and the fact that the critical period of rescission under insolvency law will only start to run if the mortgage is registered, is not ideal in most lending scenarios).

Generally, any fixtures and accessories are covered by the pledge. Equipment that is not connected to real property is considered to be movable property. With regard to security agreements in respect to movables, no specific formal requirements must be met. However, Austrian law imposes strict standards of perfection that either require a physical transfer of

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² Simultanhypothek.
the pledged goods or any equivalent measure (such as handing over via declaration) in the event the physical transfer is too burdensome to be performed. The same strict perfection requirements are required in the event of the full title transfer of such goods for security purposes (in order to avoid circumvention).

IV PRIORITY OF CLAIMS

An opening of formal court insolvency proceedings automatically leads to a stay against all actions of unsecured creditors. However, secured creditors are usually not affected by the opening of insolvency proceedings. There are three types of proceedings provided for in the Insolvency Act (reorganisation proceedings with or without debtor in possession and liquidation proceedings). Claims are classified and ranked in the following order or priority.

Secured creditors either have claims of separation to receive assets or claims of separation, or both, to receive the proceeds of enforcement after sale. Except for a possible voidance claim, neither of these claims are affected by the opening of insolvency proceedings. The secured creditor merely has to inform the administrator and, lacking acknowledgement of the claim, potentially file a lawsuit against the insolvency administrator in order to enforce the senior security. If these claims could jeopardise the business continuity of the debtor, there is a possibility that no secured claim may be paid within six months of the opening of insolvency proceedings. The provision may only be disregarded if the enforcement is vital to prevent severe economic disadvantages for the secured creditor.

Estate claims are to be satisfied next and, therefore, prior to the other insolvency claims. They encompass, inter alia, the costs of the insolvency proceedings, the expenses of the management and administration of the estate, claims for labour, services and goods furnished to the estate post-filing and the costs for the insolvency administrator. Preferential creditors of estate claims share in such claims on a pro rata basis.

Insolvency claims are claims by unsecured creditors and ranked next. They may be filed with the competent court within a time period fixed by the court after the opening of insolvency proceedings. Those insolvency creditors who file claims that were not contested by the insolvency administrator also share in such claims on a pro rata basis.

Subordinate claims may result from contractual provisions or from statutory provisions. In general, subordinate creditors only participate in the insolvency proceedings if a surplus for distribution is generated. Regarding foreign creditors, no special procedures apply. Prior to the opening of insolvency proceedings, unsecured creditors can enforce a claim pursuant to the Austrian Enforcement Act.

V JURISDICTION

i Choice of law

In general, the choice of a foreign law as the governing law for a contract is permitted, even if the contract is to be enforced in Austria; in terms of market practice this might apply to (English or German law-governed) loan agreements. However, regarding the granting and perfection of security rights there are restrictions, which depending on the type of security are in most instances governed by local (Austrian) law. This would apply among others to pledges over the shares in Austrian companies, pledges over or security assignments of Austrian law governed receivables and the creation of pledges or mortgages over Austrian real
properties. Therefore, it is common market practice that security rights over assets located in Austria or provided by Austrian domiciled transferors or pledgers are documented in Austrian law-governed security documentation.

ii Enforcement

Regarding the enforcement of judgments or awards that were not rendered in Austria, the following options are possible.

Court judgments of EU Member States

The enforcement of judgments rendered in another EU Member State is governed by Regulation (EC) No. 1215/2012 on the Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters (Brussels Ia Regulation). In Austria the Brussels Ia Regulation is applicable. Therefore, judgments from other EU Member States are recognised without any special procedure being required or any re-examination of the merits of the case (exceptions may apply, mainly with respect to Austrian *ordre public*).

Court judgments of non-EU Member States

Beyond the applicability of the Brussels Ia Regulation, enforceability of foreign judgments is conditional and depends on whether there is a bilateral treaty between Austria and the home state of the other party. A fundamental criterion is reciprocity, which is to be ensured under bilateral treaties or regulations. Additionally, it is required that Austrian law would not have denied the foreign court, having rendered the relevant decision, if the defendant in the enforcement proceedings has been duly convoked in the original proceedings before the foreign court and if the relevant judgment is final in the sense that it may no longer be challenged before the courts and authorities of the foreign state. In the event the counterparty had not had the opportunity to participate in the foreign court proceedings, the enforcement of the court judgment may be denied. A similar result applies if the enforcement is aimed at an action that may not be enforced or that is not allowed under Austrian law, or if the Austrian *ordre public* would be violated.

Arbitral awards

Austria is a contracting state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitral proceedings and the enforcement of arbitral awards are common in Austria.

VI ACQUISITIONS OF PUBLIC COMPANIES

i Regulatory legislation

The Takeover Act 1999, amended by the Takeover Act Amendment Act 2006 and most recently by the new delisting rules of 2018, regulates public bids on the primary and secondary market. It is applicable to listed Austrian companies and focuses on regulating voluntary public takeover bids while setting out the conditions that trigger compulsory takeover bids. The Takeover Act is not applicable to non-public bids and bids for shares that are not listed on a stock exchange. However, if in the course of a non-public bid a person obtains a controlling interest in an offeree company, such person will then be subject to the rules on mandatory public bids of the Takeover Act. Furthermore it is relevant regarding cross-border
takeover transactions. In case a public company is incorporated in Austria but the shares are not admitted to trading in Austria but on a regulated market of another member state of the EU, takeover bids are only subject to a number of basic provisions of the Takeover Act 1999, including, inter alia, the provisions regarding mandatory public bids.

The conditions for a public takeover are contained in the Takeover Act. Accordingly, the bidder must communicate its intention to acquire a stake in a public company without delay if there are speculations which could later alter the price of the stock. The bidder also has to inform the target’s representatives immediately, notifying them that the executive and supervisory boards have envisaged placing an offer, or circumstances compel them to place such offer. Additionally, the workers council must be notified and a financial expert must be included in the public takeover process.

The delisting rules were introduced to incorporate new EU investor protection and capital market transparency regulations. In principle, a delisting should be possible if it does not endanger the interest of investors. There needs to be a positive resolution of the annual general meeting based on a qualified majority, with an official listing over a period of three years. Also a ‘cold delisting’ under company law such as mergers were also introduced. A merger of a listed company with a non-listed company may only be filed for registration after an offer pursuant to the fifth section of the Takeover Act has been published with reference to the planned merger within the last six months prior to filing or with reference to the merger resolutions passed. Such a delisting could be based on economic factors or internal company initiatives to avoid transparency rules and competitive disadvantages associated with the stock exchange regulation.

Since December 2007, takeovers by cross-border mergers have been permitted. The legal framework for these takeovers is provided by the EU Merger Act. In this context, the Squeeze-Out Act opens up the possibility of squeezing-out minority shareholders (up to 10 per cent of the remaining shareholders) in both listed and unlisted companies.

The Foreign Trade Act can be of great importance to foreign investors when acquiring shares of 25 per cent or more in an Austrian company involved in specific protected industry sectors, such as defence equipment, energy, water supply, traffic, education and telecoms. The acquisition then requires advance approval from the Austrian Ministry of Economic Affairs.

The General Data Protection Regulation has introduced many changes to the existing rules on data protection in Austria. These changes relate to the simplification and deletion of personal data, which are processed via automated means. Also, the regulations on the permissibility of the processing of personal data concerning criminal acts have been amended. The role of the data protection officer has been clarified regarding the right to maintain secrecy and the right to refuse to give evidence. Also the sanctions regarding the penal provisions for violations of the provisions of the Data Protection Act have been modified. The new regulation no longer provides for notifications to the data processing registry. This has been replaced with an individual obligation to evaluate data processing operations. Additionally, the data protection authority may also establish and publish a list of processing operations for which a data protection impact assessment is not required.

**Public offers**

Public offers are the most common way to obtain control of a public company, whether they are voluntary or mandatory, or a voluntary bid aimed at control. Avoiding the application of the Takeover Act to public offers is possible in certain cases despite the change of control in the Austrian target, particularly if they are structured as cross-border reverse takeovers.
iii Hostile bids

Hostile bids are permitted. However, they are not as common as in some other jurisdictions due to the two-tier board structure of Austrian AGs; an AG listed on the stock exchange must have a management board and a supervisory board and publicly held shares (free float).

VII THE YEAR IN REVIEW

Though the value of M&A with target companies in Austria declined slightly in 2019, the M&A market remains stable. This downturn, however, is in line with the European trend. Factors such as global trade conflicts between the US and China and the ongoing Brexit discussions continue to cause uncertainty among investors. The most noteworthy transaction was OMV’s investment of €2.2 billion with the Abu Dhabi Oil Refining Company. Also worthy of mention was the sale by Steinhoff of Kika/Leiner to the Signa Group. This landmark transaction helped secure thousands of jobs. A significant change in legislation that has affected public M&A transactions was the introduction of new delisting rules for the Austrian Stock Exchange Act, which incorporated new EU investor protection and capital market transparency regulations. Also, due diligence processes in M&A transactions (and including finance due diligence) have been significantly impacted by changes in the Data Protection Act, with new sanctions and fines being introduced for violations of the provisions of the Act.

VIII OUTLOOK

We expect that Austria will remain an active and stable jurisdiction for acquisition and leveraged finance. Though Austria is a relatively small market, Austrian companies have a strong reputation worldwide for having excellent expertise especially in the high-end technology area. Another reason for optimism is the strong economic position of Austria generally, which is also firmly embedded in the EU. Persistently low interest rates and the existing high liquidity in the market will also continue to push the transaction market. We also expect technologically advanced Austrian companies to continue to make strides, all within a very stable economic environment in Austria.
Chapter 5

BRAZIL

Fernando R de Almeida Prado and Fernando M Del Nero Gomes

I OVERVIEW

The Brazilian mergers and acquisitions (M&A) market has gained momentum during the past few years following a period of economic stabilisation and growth that led the country to investment-grade status, consolidating Brazil’s place among the largest and most important global investment destinations. However, the investment community has been reluctant concerning the ability of Brazil to sustain this status given a serious political and economic crisis that engulfed the country earlier this decade, which peaked with the impeachment of President Rousseff. With a volatile political environment that insists on producing scandals and a string of poor economic indicators, market agents have been operating in a wait-and-see mode for the past few years. Nevertheless, the Brazilian scenario looks set to be changed in a robust manner, should the newly elected president proceed with the renewal of the economic guidelines and reforms promised in the campaign. For M&A practitioners who insist on seeing the bright side of things, some side effects of the crisis (opportunistic distress scenarios, for instance) may help to keep up with the uptick in M&A activity seen in this decade, which hopefully will preserve the country’s status as a super-emerging market.

The main drivers of M&A activity in Brazil in the past have included increased interest from foreign investors that identify Brazil as a key strategic market; consolidation in certain industries led

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1 Fernando R de Almeida Prado and Fernando M Del Nero Gomes are partners at Pinheiro Neto Advogados. The authors would like to thank the following colleagues for their suggestions for and comments on this chapter: Bruno Balduccini, Caio Ferreira Silva, Andre Marques, Giancarlo Matarazzo, Fernando Zorzo and Marcello Portes da Silveira Lobo. The authors would also like to thank Alexandre de Arruda Machado for his support in updating the chapter into its latest version.

2 ‘The M&A scene in the last couple of years can be described as being a buyer’s market. Many sale transactions have been involving distressed assets, large-scale debt restructuring and reorganisation procedures, divestment programmes of private and mixed-capital companies and sudden liquidity concerns.’ Marcello Portes da Silveira Lobo in Mergers & acquisitions in Brazil – challenges and opportunities for buyers. *Financier*, July 2016.

by local leaders; amplified participation by the government through public pension funds, government-owned entities and banks; and private equity funds taking centre stage in the M&A arena. In recent years, following a global trend, there has been considerable activity in the technology space, with IT leading the M&A rankings in number of deals (140). In the aftermath of the massive ongoing corruption scandals and investigations, the M&A community has been intensifying discussions on opportunities arising from major players swallowed by the scandals (and how to neutralise associated risks). With scandals spreading like wildfire, good deals can be found from infrastructure (construction companies with government tie-ins, such as Odebrecht, currently in judicial protection regime) to a long list of assets held by the J&F group (which controls meat producer JBS).

From a legal and regulatory viewpoint, several initiatives and reforms have paved the way for a more investor-friendly environment, such as the new bankruptcy law, the arbitration law and the creation of new investment vehicles with favourable structures for investors (e.g., the Brazilian Private Equity Fund (FIP)). Despite recently elected President Jair Bolsonaro’s questionable political ability, the government’s team has restored some good mood, continuing the reform’s proposal in a more liberal approach, a movement that started under President Temer and intensified under this new administration.

In any event, in addition to challenging macro and regulatory bases, historically high interest rates resulted in M&A activity developing without the backup of a well developed acquisition finance market. Banks dominate the lending market, with limited activity in debt capital markets. Only large companies are able to issue debt in the markets at competitive costs, which also results in lack of liquidity and a weak secondary market.

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4 Examples of locally led consolidation include sectors such as telecoms (Oi-Brasil Telecom), education services (the Anhanguera/Kroton and the Kroton/Estácio mergers were the most prominent among a high number of deals), retail (Casas Bahia-Pão de Açúcar, Pão de Açúcar-Ponto Frio, Ricardo Eletro-Insinuante), market infrastructure (CETIP and BM&F Bovespa merged to create B3), banking (Bradesco acquired HSBC Brazil and Itaú acquired Citibank Brazil and XP Investimentos retail unit in the most recent wave of consolidations) and cosmetics (Brazilian company Natura recently acquired Avon).

5 The participation of private equity sponsors reached approximately 30 per cent of announced deals in 2014 and 2015. In 2016, this number retroceded to approximately 20 per cent and remained around that range for 2017 and 2018. Important signs of the consolidation of private equity players in Brazil are recent historical fundraising for Brazil by major players in the PE space, such as Advent’s US$2.1 billion and Patria’s US$1.75 billion fundraising in 2014. In 2016, sponsors were back to successful fundraising rounds: HIG announced in April a round of US$740 million focused on middle market acquisitions. Good news is also coming from the VC market, which made strides in Brazil recently. In April 2019, SoftBank announced a US$5 billion fund to invest in tech companies in Latin America and has already invested in several Brazilian early stage companies (as Brazil naturally will grab the lion’s share of SoftBank’s allocations). These venture capital-backed names may eventually evolve to be potential LBO candidates in the near future.


7 Currently (i.e., as of September 2019), the policy interest rate sits at 5.5 per cent (a historic record low for this benchmark rate).
Leveraged buyouts (LBOs) as traditionally structured in the US or other developed markets are rare. The excessive cost of high-yield debt means that leverage may not be the most efficient form of financing in strategic or private equity deals. However, influenced by the major global private equity firms putting down roots in Brazil, a local LBO market is starting to be evidenced. Moreover, the utilisation of leverage by large strategic buyers in the local market helps to instil LBO-like characteristics in acquisitions, helping to advance the acquisition finance market in Brazil.

In 2012 and early 2013, as the Brazilian monetary authorities aggressively reduced interest rates, market players unveiled ambitious plans to consolidate a robust acquisition finance market in Brazil. Unfortunately, from April 2013 to September 2016, the monetary authorities have reversed this trend, and the policy rate jumped a staggering seven percentage points (from 7.25 to 14.25 per cent per annum) on the heels of increased inflationary expectations. The optimism regarding increased leveraged finance deal flows returned to the usual gloom concerning the cost of debt and the difficulties of using the full potential of leveraged acquisitions. Once again, since 2017 we have been able to see a consistent decrease in the policy rate, caused by a mix of short-lived optimism regarding the political horizon (considering particularly the recent approval of social security reform by the House of Representatives and discussions about tax reform, in addition to privatisations) and lower inflationary rates following the long recession – an opportunity seized by the technically well prepared team at the helm of economic policy led by Minister Paulo Guedes. Perhaps this time around market players will trust that this trend is more solid and LBOs may be on the verge of a comeback soon, considering the scenario of lower interest rates.

Against this unstable macro backdrop, with the noteworthy creativity and resilience of financial professionals and advisers, used to going about their business in unfriendly skies, the market has witnessed the structuring of a decent number of leveraged finance deals. The common features among these Brazilian-version LBOs are as follows.

### Structuring
Leveraged deals are mostly structured by the incorporation of an acquisition vehicle that takes on debt, followed by its reverse merger into the acquisition target. Under Brazilian succession rules, this structure has the same effects of leverage directly taken by or contributed to the target (i.e., the target is responsible for the debt service). In addition, deals usually are structured with fewer tranches when compared with offshore facilities (the traditional structure with revolver, senior, mezzanine junior and subordinated debt, etc., is not usual in Brazil).

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8 ‘In Brazil, the use of leverage as a PE investment strategy is still limited. Debt financing in Brazil remains very expensive due to high interest rates . . . . The typical PE strategy of a leveraged buyout (LBO) is not a commonly implemented strategy in Brazil as in more matured economies.’ Ricardo Binnie, ‘Private Equity Market in Brazil: Key Legal Issues in Fund Formation’, The Journal of Private Equity, autumn 2013. ‘The reason that private equity firms in Brazil do not use debt is simple: In Brazil, money does not come cheap . . . .’ Andrew Ross Sorkin, ‘In Brazil, No Room for Leverage at Buyout Firms’, New York Times, 28 March 2011.
ii **Borrowers**

Although sponsors are becoming more common in the Brazilian M&A arena, most acquisition finance deals are struck by large strategic buyers that are able to leverage their relationship with local banks and obtain cheaper financing costs. This evidences that the local culture in acquisition finance is to provide credit to the buyer rather than to the target, with credit decisions made more based on the soundness of the buyer and less on the ability of target to generate free cash flows.

iii **Lenders**

Financing is primarily provided by local banks. Syndicated deals and bond (debentures) underwriting structures are less common, and banks tend to commit and hold these loans in their books. The lack of a well developed secondary market affects the ability of banks to use ‘best-efforts’ structures and spread the risk with institutional investors. This increases costs and limits credit supply in the market. Coupled with the high costs to hedge foreign exchange exposure and the high concentration of the Brazilian financial system in the hands of local players, this scenario substantially hurts the competitiveness of foreign players in acquisition finance. Lower interest rates are available through subsidised loans granted by government-owned banks, notably the National Development Bank (BNDES). The prominence of BNDES increased significantly in the past two decades as it has provided

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9 Noteworthy sponsor-backed deals with LBO-like features include GP Investments’ acquisitions of San Antonio, Magnesita and Fogo de Chão, Carlyle’s acquisitions of Qualicorp and Tok&Stok, Apax’s acquisition of Tivit, Vinci Partner’s acquisition of PDG and Bain Capital’s acquisition of Internorma. See ‘Fundos Turbinam Ganhos com uso de dívida em aquisições’; Valor Econômico, 10 October 2012.

10 Taking BNDES out of the equation, the four largest banks in Brazil concentrate nearly 80 per cent of total assets in the system, and all of them are local: Banco do Brasil, Caixa, Itaú Unibanco and Bradesco. Santander, the fifth in the list, is the only foreign player with a national presence. Bradesco concluded the acquisition of HSBC’s operations in Brazil (the sixth in the list). Also, Citi (a top 10 retail bank with historical presence in Brazil) recently sold its retail operations to Itaú Unibanco, further contributing to this situation.

11 The participation of BNDES in the total credit available in the Brazilian market reached 23 per cent in December 2014, but it is more illuminating to analyse BNDES’ total assets evolution in the past 10 years: in 2003, assets totalled 164 billion reais, while in 2015 this reached 931 billion reais (compound annual growth rate of 16 per cent in the period): www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_pt/Galerias/Arquivos/empresa/download/Inf_Contabil_Externo_1215_BNDES.pdf. In 2016, under new administration, total assets dropped to 876 billion. It is important to note that BNDES financing follows strict regulations and guidelines and can be obtained for specific sectors falling under pre-approved special credit lines (see the Central Bank’s study on interest rates and spread at at www4.bcb.gov.br/pec/gci/port/focus/FAQ%201-Juros%20e%20Spread%20Ban%C3%A3o%20BNDES.pdf). The centre-stage role taken by BNDES in acquisition finance is part of a broader story. The market has been closely watching the Brazilian public sector banks grow their loan books exponentially while private players took a more cautious approach (to take more recent numbers, while private banks credit portfolio rose 5.4 per cent from April 2014–April 2015, public sector banks rose its portfolio by 15.5 per cent). By March 2015, the public banks’ outstanding credit rose to 54 per cent of the total (Caixa Econômica Federal, Banco do Brasil and BNDES – all three government-controlled – being the top three banks in total credit in Brazil. Over the past few years, economists and multilateral bodies (including the International Monetary Fund (IMF)) have voiced their concerns about this situation. Besides an increased participation of the public sector in the economy, experts feared that a credit bubble was being sponsored by the government, creating difficulties for public banks to maintain healthy capital ratios (mainly in the face of Basel III) and delinquency levels. Several specialised publications have been covering this trend; for example, see ‘Brazil:
financial support to several important M&A transactions in the Brazilian market at interest rates substantially below the policy rate. However, under Bolsonaro’s administration, the BNDES has taken a completely different approach and has notably slowed down its direct involvement in the lending space. This fact, coupled with historic low policy interest rates, is expected to increase the relevance of capital markets solutions in acquisition financing in the near term.

iv Leverage levels

As expected in view of high financing costs, leverage levels tend to be lower when compared with those of US deals. While it is not unusual to use a debt-to-finance ratio of 60 to 80 per cent of the purchase price in a US LBO, in Brazil this ratio rarely reaches the 50 per cent mark. To put things in perspective, while in developed markets financial leverage drives on average 33 per cent of private equity returns, in Brazil this number is only 3 per cent, leaving all upside to operational improvements and growth.

These characteristics point to the uniqueness of the Brazilian acquisition finance market. Market players overcome one of the highest financing costs in the world, putting together important acquisition finance structures and local versions of LBOs. In addition, legal and regulatory aspects affecting the acquisition finance in Brazil are far from straightforward, featuring a highly regulated financial market and complex tax system.

II REGULATORY AND TAX MATTERS

i Regulatory overview

When dealing with the regulatory aspects of acquisition finance and debt structuring in Brazil, the most important regulatory bodies are the Central Bank of Brazil (Central Bank) and the local Securities and Exchange Commission (CVM). Both entities are under the supervision of the National Monetary Council (CMN), the body ultimately responsible for the Brazilian financial system.
Broadly speaking, financial institutions are regulated by the Central Bank. Only those institutions authorised by the Central Bank are legally allowed to originate and provide credit on a regular basis as their main activity. The risk for institutional investors or other entities that engage in the provision of loans or credit origination is to be deemed financial institutions without proper authorisation, which can lead to severe sanctions, including in the criminal sphere.

Under the above scenario, a non-financial investor may invest in credit instruments but should be careful not to engage in credit origination and lending with proprietary capital as its principal activity. Although traditional capital markets financing and secondary markets remain timid in Brazil (owing to the combination of high interest rates and the prominence of large banks and government banks as the main agents of credit), a number of alternative credit markets have developed to fill the void.

Among these alternative funding structures, the development of securitisation is noteworthy. Securitisation structures cover a wide spectrum of receivables, ranging from personal banking loans to complex infrastructure projects, fostering the development of a credit secondary market. Two important regulatory milestones in the early 2000s helped foster this market: the creation of financial securitisation companies and the emergence of receivable funds (FIDCs), regulated both by the Central Bank and the CVM.

While financial securitisation companies never gained much traction, FIDCs became a popular, widely used alternative structure to the traditional funding sources in Brazil. Factors such as favourable tax treatment and structuring flexibility attracted several local and foreign investors, leading FIDCs to post double-digit yearly growth in assets. Currently, in excess of 50 billion reais are under management by FIDCs, and industry experts forecast that this could reach over 180 billion reais in the next 10 years. However, the utilisation of FIDCs and securitisation structures has been less common in leveraged finance structures.

More recently, important regulatory changes and the creativity of financial sponsors and their local advisers are playing an important role in helping jump-start a new wave of LBOs.

Most private equity deals in Brazil are structured through the previously mentioned special type of investment fund, the above-mentioned FIP. FIPs emerged in 2003 in an attempt by regulators to provide financial sponsors with a sophisticated and flexible structure.
to conduct investments in Brazil that offered clear advantages compared to the traditional corporate structures.\textsuperscript{20} Several features, including tax incentives, contributed to the success of FIPs and ultimately to the reshaping of local M&A deal structuring.\textsuperscript{21}

Although FIPs are not allowed to take on debt, they have recently been authorised to provide guarantees and collateral to the benefit of their holdings. This holdco-level backstop allows financial institutions to provide cheaper financing to SPVs and targets of private equity investments, allowing more transactions to be structured as Brazilian-version LBOs in the local market. The success of these guarantee structures, yet to be tested in terms of structural and financial feasibility, has the potential to start a new chapter in the development of acquisition finance and sponsor-backed M&A in Brazil.

\section*{ii New regulatory topics}

Among new regulatory topics affecting debt financing in Brazil, two in particular have attracted attention and called for specific measures by local agents.

\subsection*{Anti-Corruption Law, compliance due diligence and protection for buyers}

A new Anti-Corruption Law became effective on 29 January 2014. Although not aimed specifically at financial institutions or institutional investors, its close ties with anti-money laundering provisions make it a hot topic for lenders. The new law brought about heightened anti-corruption standards, including the introduction of concepts from the Foreign Corrupt Practices Act and the mandatory introduction of anti-corruption policies and compliance training within companies.\textsuperscript{22} Financial institutions already subject to anti-money laundering will have to adapt current structures to comply with the provisions of the new Anti-Corruption Law, and this trend can be seen in acquisition finance structures already (banks are requiring targets to represent compliance with anti-corruption law).

\begin{itemize}
\item \textsuperscript{20} ‘The most popular private equity vehicle in the Brazilian M&A practice is by far the FIP, whose structure bears some similarity to the partnership fund model generally adopted in the US and in Europe . . . CVM introduced FIPs to Brazil through Rule No. 391 (CVM Rule 391/03), issued on 16 July 2003. By laying down the legal and regulatory grounds for the establishment of an investment conduit that local and foreign investors formerly lacked when sponsoring private equity ventures in Brazil, CVM Rule 391/03 largely contributed to a rapid expansion of FIPs in M&A deals. More importantly, investments and exit strategies successfully implemented by FIPs since 2004 created an encouraging track record that helped Brazilian private equity-backed M&A transactions achieve high priority on the agendas of institutional investors.’ José Carlos Meirelles and Caio Ferreira Silva, ‘Brazilian Private Equity Funds FIPs: A DNA Change in Brazilian M&A Deals’; \textit{Harvard Business and Law Review} online, Volume 4, 2013.
\item \textsuperscript{21} ‘The regulatory flexibility and generally favourable tax regime accorded to FIPs make FIPs a unique and powerful tool for structuring M&A transactions involving targets in Brazil. Additionally, investors can utilise FIPs for fundraising, deal financing and implementing exit strategies, as applicable CVM regulations allow the placement of their units in the market.’ (Meirelles and Silva, ibid.)
\item \textsuperscript{22} ‘It will certainly cause corporations to undergo significant changes in the way they conduct their operations in Brazil, to the extent that training of employees and adoption of compliance programmes will become mandatory corporate governance measures. While multinational companies and national companies with operations abroad or with stocks or securities on foreign stock exchanges have already adhered, to a lesser or greater extent, to compliance programs, other companies must get prepared to be brought in line with the provisions of the Bill’. Marcos Restrepo, ‘The Anti-Corruption Bill’, \textit{Biblioteca Informa Newsletter}, Pinheiro Neto Advogados, 13 July 2013.
\end{itemize}
Significant issues arising from the implementation of the Anti-Corruption Law soon became apparent in the context of the successive corruption scandals that emerged in Brazil. These include:

a. the emergence of multiple opportunities to acquire assets and companies that were fundamentally successful but implicated in corruption scandals;
b. the need for buyers and finance providers to measure and protect against the risk arising from compliance and corruption-related actions in the target companies;
c. heightened due diligence standards;
d. contractual implications, mainly related to buyer projections, termination events and MAC; and
e. the need for specific legislative regimes to ensure limitation of liability for buyers of toxic assets, to preserve economic activity.

The fact that several of the players involved in corruption scandals ended up in court protection regimes\(^23\) may relieve some of the concerns resulting from specific protections afforded to purchasers by the Brazilian Bankruptcy Law,\(^24\) but there are still uncertainties related to certain succession risks (such as corruption losses) that will require adaptation from agents in the market and will create a new baseline for what is ‘market’ in deal documents.\(^25\)

**Social–environmental risk management**

Until 2012, the observance by local financial institutions of social and environmental standards in lending and financing activities was voluntary. Some major players had set up independent structures to comply with international accords such as the Equator Principles.\(^26\) In April 2014, the CMN extended the social-environmental responsibilities to all entities operating under the Central Bank’s authorisation\(^27\) by introducing the social environmental risk policy (PRSA). It should be noted that financial institutions must observe this policy

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23 Notably, OAS, a major contractor involved in bribery scandals, sought court protection under the Brazilian Bankruptcy Law.
25 ‘Sale and purchase transactions in the context of debt restructuring may offer certain protections against customary succession risks, provided that the applicable requirements are met. On the other hand, indemnities for other matters may not be on the table for a variety of reasons, including the multiplicity of stakeholders. Such transactions may require negotiation with, and acceptance of the deal by, the seller, its creditors, courts and the judicial administrator, just to name a few. Depending on the relevant industry, the regulatory agency or granting authority may also play an important role as changes of control are usually subject to approval and compliance with financial, technical and legal qualifications by the buyer. . . . So, what is left in terms of protections for the buyer? The due diligence should be even more thorough and detailed than usual, with a special focus on compliance matters, not only with respect to the target company, but also the seller, its corporate group and other companies involved in the business. Security or collateral arrangements should also play an important role, considering the difficulty and cost associated with obtaining bank guarantees or M&A insurance in the current market.’ Marcello Portes da Silveira Lobo in ‘Mergers and acquisitions in Brazil – challenges and opportunities for buyers’, *Financier*, July 2016.
26 The Equator Principles were strictly observed by some financial institutions that participated in controversial project finance structures for the construction of mega hydropower plants in the Amazon region (Jirau, Santo Antonio and Belo Monte plants).
27 CMN Resolution 4327 of 25 April 2014.
not only for their own activities, but also when providing financing to entities. As financial institutions are rushing to adapt their structures to comply with the PRSA, it is unclear to what extent the enforcement of the new policies will take place and how strict the supervising authorities will be. The new rules mandate the creation of policies, tools and controls, but do not extend liability to the financial institutions for damages caused by their clients. The PRSA should certainly be on the radar of market players structuring LBOs in Brazil.

In addition to these topics, the antitrust law reform of 2011 affected the M&A market and, consequently, acquisition finance structures: from June 2012, Brazil became a ‘pre-merger system’, under which merger reviews by antitrust authorities are conducted pre-closing, unlike the previous post-factum reviews. Broad gun-jumping provisions may also cause uncertainties to parties in M&A situations. Waiting periods and conditions precedent-related to antitrust approvals should always be kept in mind by lenders while negotiating leveraged acquisition structures.

iii Tax aspects

As a general rule, the interest expenses incurred under financing transactions, although generally deductible at the level of borrower, are taxable in the hands of the creditor. If interest is paid out to Brazilian legal entities, Brazilian ordinary corporate taxation is applicable. On the other hand, if interest is paid out to non-residents, Brazilian withholding tax (WHT) is due at a general rate of 15 per cent (a 25 per cent rate is applicable if the beneficiary of the income is located in a tax-haven jurisdiction). The WHT rate applicable to interest paid by a Brazilian party to non-residents could be reduced if a double taxation convention (DTC) signed between Brazil and the country in which the beneficiary of the interests is located exists (e.g., under the Brazil–Japan DTC, the WHT rate applicable to remittance of interest from Brazil could be reduced to 12.5 per cent).

In the acquisition finance space, the hot tax topic is the discussion of interest expense deductibility in LBO transactions. In deals with LBO features, tax authorities have frequently questioned the ability of the target to deduct interest expenses for tax purposes. The main argument used by tax authorities relates to the fact that excessive indebtedness was

28 ‘In order to comply with the Resolution, the institutions shall maintain an adequate governance structure for implementation, monitoring and effectiveness of the PRSA, including by means of the – optional – creation of a social and environmental responsibility committee to this end. The institutions shall establish an action plan for implementation of the PRSA, which plan, together with the PRSA policy, shall be approved by the Executive Board . . . and, if any, by the Board of Directors . . . of such institutions. Each institution shall appoint an officer responsible for compliance with the PRSA, and provide for the internal and external disclosure of such policy’. Werner Grau, Maria Christina Gueorguiev and Rosine Kadamani, Biblioteca Informa Newsletter, Pinheiro Neto Advogados, 24 June 2014.

29 ‘On 29 May 2012, the new Brazilian Competition Act (Law No. 12529, enacted on 30 November 2011) (Act) became effective, replacing the former law enacted in 1994. The new Act will change the Brazilian competition system significantly and will have a direct impact on the merger control notifications. In general terms, doing business in Brazil will be affected as the Act now imposes mandatory waiting periods for the implementation of transactions. “Gun jumping” issues will also be taken into account to consider potential fines and negative consequences.’ Leonardo Rocha e Silva and Alexandre Buaiz Neto, ‘New Rules on Merger Notifications in Brazil’, LexisNexis Emerging Issues 6727, 2012.

30 As seen above, the main structure utilised in these deals with LBO-like transactions in Brazil is the set-up of an acquisition vehicle that obtains leverage in the market (almost exclusively via bank loans), following a reverse merger whereby the target is the surviving entity, bringing the leverage effects to its balance sheet.
not necessary for the day-to-day operations of targets. We are aware of a few precedents in which tax authorities have issued notices of tax assessments to LBO targets that allegedly used excessive leverage to pay less tax (these cases are under discussion with the tax authorities). However, we can say that this type of challenging of tax authorities has become more common in the past couple of years.

Tax law experts have taken a critical stance on the positioning of the tax authorities, which can be credited to the tax authorities’ lack of understanding of the LBO structure and its benefits in advancing corporate development. Among their arguments to challenge these views, experts include:

a. the business and financial reasoning behind LBOs;
b. from the legal and financial standpoints, the success of the structure in several jurisdictions;
c. the fact that tax statutes foresee specific situations whereby holding company structures are used for acquisition and tax deductibility arising therefrom; and
d. a presumption in the tax laws that interest expenses are generally deductible.

In addition, although Brazilian tax legislation does not expressly regulate LBO transactions, one could substantiate the deductibility for tax purposes of the interest expenses assumed by the target based on the arguments that the debt obligation was originally incurred by the buyer in the regular course of its business, therefore leading to tax-deductible interest expenses; and the acquisition of the target by the buyer is expected to improve the business operations and generation of income of the target, therefore adding to the argument that the allocation of interest expenses to the target should not be viewed as unusual and unnecessary to the execution of its business.

Fortunately, so far the Tax Payers Council (the administrative body responsible for the analysis of tax infractions notices issued by tax authorities in Brazil) has adopted a favourable position when dealing the matter. Recently, the Tax Payers Council issued a decision recognising the deductibility of the interest expenses incurred upon an LBO transaction, stating that loans taken to finance acquisitions of equity interest should be considered as a common and regular operation. In addition to this good precedent, a recent reform on mergers and consolidation rules for public companies enhanced the list of arguments to defend this position. In the past, the reverse merger of a leveraged financing vehicle into a listed company was considered abuse of control power and this was used as an argument by tax authorities, but this restriction was lifted in the new rule.

Note that objective limitations to interest expense deductibility in LBO structures include:
a. leverage being connected to an acquisition performed at market conditions;
b. all records and documentation relating to the interest expense being present;
c. actual utilisation of the funds to perform the acquisition; and

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31 See Giancarlo Matarazzo and Rubens Biselli’s article on the matter in Revista Dialética de Direito Tributário No. 228.
33 CVM Instruction No. 565 of 15 June 2015, which amended and revoked provisions of CVM Instruction No. 319 of 3 December 1999, dealing with the topic of mergers and consolidations of public companies.
d observance of the transfer-pricing\textsuperscript{34} and thin-capitalisation rules in cases where the beneficiary is considered a related party or is domiciled in a tax haven jurisdiction.

Thin capitalisation rules in Brazil are relatively recent and were introduced by Law 12249 of 11 June 2010. Under the rules, thin capitalisation occurs whenever the capital of a company is irrelevant when compared with the liabilities maintained in face of equity holders. The scope of Brazilian thin capitalisation rules comprises debt granted by equity holders, debt granted by other affiliates and debt granted by any entity domiciled in a tax haven jurisdiction, regardless of corporate affiliation.

III SECURITY AND GUARANTEES

i Fiduciary sale

When structuring debt deals and acquisition finance guarantee packages, the main goal of lenders is to ensure quick access to assets, preferably without bankruptcy and insolvency risk. In this scenario, the fiduciary sale or assignment in guarantee\textsuperscript{35} has become the most common type of guarantee in the financial markets. Law 10931 of 2 August 2004, which amended Law 4728 of 14 July 1965, extended the application of the fiduciary sale to transactions executed within the financial and capital markets, which prompted an exponential increase in the use of this collateral structure.\textsuperscript{36}

Among the characteristics of the fiduciary sale, two are of great importance for the widespread utilisation of this specific type of guarantee: the relative ease of foreclosure in an event of default (including the possibility for the creditor to perform an extrajudicial sale of the assets given in collateral), and the fact that assets given in the fiduciary sale would have special priorities and enhancements in insolvency and reorganisation proceedings involving the debtor.\textsuperscript{37}

\textsuperscript{34} Law 9430 of 27 December 1996 imposes a limited interest rate up to which tax deductibility can occur with respect to loans granted by affiliated entities.

\textsuperscript{35} In general terms, a fiduciary sale is a title retention mechanism whereby the fiduciary property of the asset is transferred to the creditor as collateral. In the event of a default, the fiduciary property consolidates to the benefit of the creditor. If all secured obligations are complied with, the creditor has the duty to transfer the title of the asset back to the debtor.

\textsuperscript{36} A fiduciary sale within the financial markets differs from the traditional fiduciary sale set forth by the Brazilian Civil Code to the extent that the latter refers to liens on non-fungible assets, while the former encompasses liens on fungible assets and credits. A real estate fiduciary sale is dealt with in a different law, and has specific features.

\textsuperscript{37} Compared with other types of collateral, such as pledges, mortgages and other \textit{in rem} guarantees, this is an important advantage. In this sense, while claims secured by pledges, mortgages and other similar structures have certain priorities in liquidation regimes, beneficiaries of fiduciary sales may foreclose on or request the restitution of the assets granted as collateral and sell these assets outside of the liquidation proceeding. Similarly, in a judicial reorganisation proceeding (similar to a Chapter 11 proceeding), holders of claims secured by fiduciary sales are not subject to the effects of the reorganisation (e.g., not subject to the terms of the reorganisation plan) and may foreclose on the collateral at any time (apart from when the collateral is essential to the debtor’s business – in this circumstance, the foreclosure would be stayed during the 180-day stay period). Courts have generally observed and consolidated this priority of the fiduciary sale.
Creditors should be aware that proper formalisation of guarantees such as fiduciary sales is of utmost importance in Brazil to ensure the priorities and enhancements set forth in law. In this regard, fiduciary sales are perfected in writing, by means of a public or private document filed at the relevant office of the Registry of Deeds and Documents located in the debtor’s domicile.\(^{38}\) However, creditors tend to take a conservative stance and proceed with the registration in both creditor’s and debtor’s place of business (in case of different headquarters or multiple establishments). This additional measure is to ensure enforceability against third parties, but will not affect the validity or effectiveness of the guarantee if not conducted.

There has been some controversy regarding the legitimacy of foreign financial institutions being the beneficiaries of fiduciary sale guarantees under the terms of Law 10931. The prevailing understanding is that foreign financial institutions can indeed be beneficiaries of such guarantees on the grounds that Brazilian law cannot differentiate between foreign and local financial institutions in similar structures. If transactions with equal structure carried out by Brazilian financial institutions are deemed ‘within the scope of financial and capital markets’, the same treatment should be afforded to transactions carried out by foreign financial institutions facing Brazilian companies. This understanding has not yet been confirmed by the courts.\(^{39}\)

\section*{ii Potential risks in an insolvency scenario}

Brazilian law does not have specific provisions characterising LBOs in the context of insolvency procedures and the extent to which indebtedness assumed in an LBO could be challenged.

Lenders structuring credit facilities and guarantee packages should be aware that there is a theoretical risk that the indebtedness assumed or guarantees granted by the target company are challenged by creditors existing at the time the LBO is implemented based on the general protection rules (e.g., rules concerning fraud against creditors) set forth in the Civil Code or on specific provisions set forth in the Brazilian Bankruptcy Law. A creditor may argue, for example, that the target company did not receive direct consideration or benefit as a consequence of the LBO, and that, as a result of the indebtedness, the target company became insolvent. We are not aware of any lawsuit that has been filed based on such a fact pattern (LBO), and believe that the economic reasoning and business benefits that may arise from an LBO are good arguments against these claims.

\(^{38}\) Article 1361 of the Civil Code. Note that, depending on the underlying asset subject to the fiduciary sale or guarantee, additional procedures need to be undertaken, such as in the case of shares (registration of the fiduciary sale with the bookkeeping agent) or real estate (proper registration of the line with the competent real estate registry).

\(^{39}\) With regards to a fiduciary sale of real estate, there has been controversy on the legitimacy of foreign entities as beneficiaries of the fiduciary sale. In view of this, structuring guarantees as traditional mortgages is the safer path to avoid questioning by debtors and local authorities.
IV PRIORITY OF CLAIMS

In the event of liquidation, the Brazilian Bankruptcy Law sets forth a ranking of claims to be paid in a waterfall model with the proceeds obtained from the sale of the debtor’s assets. This ranking also applies to extrajudicial liquidation proceedings of financial institutions.

After payment of super priority claims and expenses (including labour-related claims of a salary nature maturing in the three months preceding the liquidation adjudication; expenses essential for the management of the bankruptcy estate; the realisation or payment of claims for restitution (e.g., creditors holding claims secured by a fiduciary sale have the right to repossess their collateral to sell it outside of the liquidation proceeding); payment of the post-petition claims (including debtor-in-possession financings and the trustee’s fees), the balance of the proceeds received as a result of the liquidation of assets must be used to pay the pre-petition claims, in accordance with the following order:

a. labour-related claims, limited to 150 minimum wages per creditor (amounts exceeding this cap are reclassified as unsecured claims), and occupational accident claims;
b. secured claims (secured by *in rem* guarantees such as mortgage and pledge) up to the value of the collateral;
c. tax claims, except for tax fines;
d. special privilege claims (defined in civil and commercial laws);
e. general privilege claims (defined in civil and commercial laws);
f. unsecured claims;
g. contractual penalties and monetary penalties for breach of criminal or administrative law, including tax law; and
h. subordinated claims.

i Second liens

Certain types of security interest such as pledges and mortgages are subject to multiple liens (first, second, third liens or more). Given their nature, security interests composed of fiduciary property (i.e., fiduciary sale or fiduciary assignment) are not subject to multiple liens. Structural subordination requirements in Brazilian leveraged deals are typically not required (usually subordinated within the target’s capital structure).

ii Intercreditor agreements

Intercreditor agreements are common practice in Brazil, and there is little controversy about their enforceability and effectiveness. Even in highly complex insolvency situations involving syndicated facilities, courts tend to accept the validity of intercreditor provisions. However, the legal ranking of claims applicable to liquidation proceedings (indicated above) will not be amended to reflect the subordination set forth under intercreditor agreements. In this sense, if a group of unsecured creditors agree to a structural subordination under an intercreditor agreement, it is likely that under the liquidation proceeding all creditors will be paid in

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40 This ranking of claims is not applicable in the reorganisation regimes set forth in the Brazilian Bankruptcy Law. Under such proceedings, as a general rule, the plan will describe how the creditors subject to the reorganisation regimes will be paid.

41 Limited to five minimum wages per employee.

42 DIP financing is a novelty in the Brazilian legal system (introduced by the Bankruptcy Law in 2005) and does not have the same enhancements of the DIP financing under the US Bankruptcy Code.
the same proportion in the liquidation proceeding and will have to make the necessary
arrangements among themselves (e.g., through an agent) to reflect the subordination agreed
upon under the intercreditor agreement.

Other issues concerning intercreditor agreements relate to:

- correct and complete identification of the collateral enforceability mechanism in the
  intercreditor agreement, including sufficient granting of powers to agents acting on
  behalf of creditors; and
- the ability (standing to sue) of the collateral agent acting on behalf of a foreign creditor
to effect local foreclosure of collateral and remit abroad funds obtained to satisfy the
obligations.

With the widespread use of intercreditor agreements, local banks in charge of foreign exchange
are becoming familiar with the structure, and the concern regarding (a) has been mitigated.

V JURISDICTION

i Choice of law and jurisdiction

The basic principles of private international law were incorporated into Brazilian law by
Decree Law No. 4657 of 4 September 1942 (usually known as the Law of Introduction to
the Rules of Brazilian Law). This law establishes that agreements should be governed by the
law of the country in which they were entered, but does not exclude the contractual freedom
of the parties to elect the law that will govern the rights and obligations under international
agreements. Nevertheless, this principle of accommodation of will by Brazilian law is not
without limitations.

In principle, the right of the parties to choose the governing law of agreements depends
on the existence of a link between the underlying transaction to be performed and the law
selected by the parties to govern their obligations. A general limitation applies to the choice
of law: the governing law should not violate Brazilian national sovereignty, public policy and
good morals or ethics.

Notwithstanding the foregoing, in practice Brazilian courts tend to apply Brazilian law
in disputes that should be governed and judged by foreign law. Therefore, if an agreement is
to be enforced directly before the Brazilian courts, ideally it should be governed by Brazilian
law because the courts are likely to ignore foreign law.

There are certain matters over which Brazilian courts have exclusive jurisdiction: deciding on actions relating to real property located in Brazil; and examining and deciding on probate proceedings of a deceased person’s Brazilian estate, even though the deceased was a foreigner and resided outside the country. In addition, any bankruptcy or judicial proceedings must be filed at the courts where the company is headquartered. Outside of these matters, Brazilian courts should have no exclusive jurisdiction.

Nonetheless, the filing of a lawsuit before a foreign court does not preclude the
Brazilian courts from judging the same case if the defendant, whatever its nationality, is
domiciled in Brazil; the obligation is to be performed in Brazil; or the actions result from a

43 Nonetheless, if the disputes under the agreement are subject to arbitration in Brazil, the parties can freely
choose the governing law and rules.
fact that occurred or an act performed in Brazil. Thus, in acquisition finance scenarios with obligations to be performed in Brazil and guarantees set up locally, Brazilian courts will always have concurrent jurisdiction.

Judgments obtained abroad may be enforced in Brazil without re-examination of the merits of the case, provided such judgment is final and unappealable, and previously confirmed by the Superior Court of Justice (STJ) in an exequatur process.

Such confirmation or exequatur by the STJ generally takes from six to 18 months to be granted and it is available only if:

a. the judgment fulfils all formalities required for its enforceability under the laws of the country where the judgment was issued;
b. the judgment was issued by a competent court;
c. the parties involved were duly summoned before the foreign court;
d. the judgment is final and not subject to appeal;
e. the judgment was legalised by a Brazilian consulate in the country in which the judgment was issued and is accompanied by a certified translation into Portuguese; and
f. the judgment is not manifestly against national sovereignty, public policy and good morals or ethics.

Once the foreign judgment has been confirmed, it may be enforced before the relevant Brazilian lower court (usually the courts of the location of the debtor or defendant). Any payment of a debt stated in foreign currency may only be made in Brazilian currency (by means of applying the exchange rate prevailing on the date of actual payment).

Some of the issues discussed above may, however, be prevented by the inclusion of the choice of arbitration in the transaction agreements. An arbitration clause, providing the arbitration tribunal is seated in Brazil, would allow the parties to freely choose the applicable law, avoid concurrent jurisdiction issues and allow the lender to directly enforce the agreement or arbitration awards before the Brazilian courts without the prior confirmation of the STJ.

ii Pre-enforcement procedures

In Brazil, agreements, decisions and arbitral awards may be judicially enforced if the debtor fails to comply with its obligations. However, this does not mean that Brazil’s legal system does not allow for an extrajudicial enforcement procedure. Foreclosure of a fiduciary sale, for instance, may be carried out extrajudicially in certain situations (e.g., when the encumbered asset is a real property or when the creditor is in possession of the encumbered asset).

Regardless of whether the enforcement will be implemented judicially or extrajudicially, there are certain pre-enforcement procedures that must be complied with by the creditor. These pre-enforcement procedures should help lenders to prove that the debtor had all the necessary chances to cure a default, regardless of whether such default relates to a breach of financial covenant or failure to repay related debt instalments; supplement the collateral; and prevent any foreclosure of the granted security interest.

These procedures should be also followed if the main agreement is governed by foreign law. For instance, if New York law is the governing law of the loan agreement, any potential default of the debtor shall be evidenced before the laws of New York and in accordance with pre-enforcement procedure precedents.
VI  ACQUISITIONS OF PUBLIC COMPANIES

i  Going-private transactions in Brazil

Although the Brazilian market has seen a reasonable number of going-private and delisting transactions, there are few, if any, issues in these deals that relate to acquisition finance. The same reason noted above for the limited number of LBOs in Brazil applies to going-private transactions: prohibitive interest rates hinder more prolific activity by sponsors and other investors to structure a leveraged going-private deal. On top of that, the fact that the number of publicly traded companies with dispersed control in Brazil (true corporations) can be counted on one hand limits the situations of public-to-private transactions dependent on leverage.

In this sense, noteworthy going private transactions in the Brazilian market are usually ‘elephant’ deals conducted by large strategic players in specific situations.\textsuperscript{44} Examples include UnitedHealth’s acquisition of Amil, BicBanco’s acquisition by China’s CCB (the latter two followed by a minority delisting tender offer), the \textit{LAN-TAM} merger and Redecard’s take-private deal by Itaú, its controlling shareholder. In 2014, Santander Spain concluded an exchange tender offer to delist Santander Brazil, offering shares of the parent bank in exchange for the subsidiary shares. In the wake of the Santander tender offer, other controlling shareholders followed suit, taking back private companies that listed a minority stock (probably owing to the overall poor performance of the stock market over recent years and increased investor pressure). This happened with a number of companies, including the local unit of Souza Cruz, Banco Daycoval and BHG.

In any event, going-private transactions have to follow specific requirements set forth by CVM Instruction 361, of 5 March 2002, which governs tender offers. Among the several types of tender offers, CVM Instruction 361 defines the ‘going private tender offer’ or ‘delisting tender offer’, prescribing a mandatory tender offer at fair price as a condition for the cancelling of the registration of a public company.

One issue that may come up relating to debt financing is the equitable treatment of shareholders in the context of a tender offer. Article 4, II of CVM Instruction 361 requires that minority shareholders are treated equally within an offer, including with respect to information on the company and the offeror. In the event that the offeror is obtaining acquisition finance from a financial institution that is also a minority shareholder or has an affiliate that is a minority shareholder, this should not entail additional advantages to this shareholder-lender when compared with the others (which may be difficult to sustain given that naturally, as a lender, the minority shareholder will have better and more complete information than the other minority shareholders). To minimise risks of questioning, the transaction should be conducted at arm’s length and the maximum amount of information made available to the lender should also be available in the tender offer prospectus.

ii  Squeeze-outs under Brazilian law

The squeeze-out of minority shareholders was introduced in Law No. 6,404 of 15 December 1976, as amended (Corporation Law) as part of a reform passed in 2001 aimed at improving corporate governance and minority shareholder rights.

\textsuperscript{44} Notable exceptions of a going-private transaction conducted by a financial sponsor is the acquisition of Tivit by Apax and the recent acquisition of Abril Educação’s control by Tarpon. Also recently, the failed attempt to a sponsor-led take private transaction of BR Properties showcased the difficulties of conducting a large take-private deal in Brazilian capital markets.
Along with the additional protection afforded to minority shareholders, which basically requires a tender offer at fair price and the acceptance (or consent) of more than two-thirds of the minority shareholders registered to participate in a special auction as a condition for the delisting, the new legislation permits a squeeze-out in the event that the tender offer is successful (i.e., the company is delisted) and the controlling shareholder holds more than 95 per cent of the company’s share capital after the offer.45

One important concern that arises in squeeze-out transactions relates to the inability of the offeror to reach the minimum 95 per cent threshold during the delisting auction. In such a case, some alternatives are available to the offeror: it can obtain the 95 per cent threshold in the three-month period following the auction (the put-right period)46 or it can privately negotiate with the minority shareholders.

VII OUTLOOK

Having undergone a second impeachment process in 30 years since redemocratisation, Brazilian institutions displayed a notable resistance. Although the bad news in the economy continues to force market agents to constantly review (downwards) projections, the possibilities for accelerated fiscal adjustment and urgent reforms are refuelling the cautious optimism catalysed by a new economic cabinet filled with brand new faces in the local financial markets. The unknown variable is how long it will take this economic team to put the country back on the growth track, and the toll the adjustments will take on a wounded economy. Although we do not know if the political turmoil is at an end, the labour reform approved in 2017 has been consolidated and is returning positive outcomes. Moreover, the new Minister of Economy has been doing a great job since the approval of social security reform by the House of Representatives, the resumption of discussions about tax reform and also the proposals to reduce the size of the Brazilian state, privatising inefficient state companies and restructuring the course of public spending.

Despite the world-class economic team, the political uncertainties continue to affect the acquisition finance market. Brazil experienced a historical decrease of 3.6 per cent in its GDP in 2016, with a notable decrease in the investments component and bounced back in 2017. However, projections of a new trend of growth have been frustrated by subpar performance of the economy in 2018 and 2019, against the internal political uncertainty backdrop and some international uncertainty surrounding emerging economies. This macro environment is a significant hurdle to any further escalation of acquisition finance activity. However, with these challenges come opportunities, with a depreciated local currency and

45 The CVM’s interpretation is that if a significant amount of shareholders accept the tender offer, and the remaining balance accounts for less than 5 per cent of outstanding shares, the value offered on the tender offer is considered to be a fair value and there is no reason for a private company to be obliged to maintain a few shareholders in its ownership structure, also incurring in the corresponding additional expenses.

46 There is some controversy regarding the interpretation of the CVM on the feasibility of meeting the 95 per cent threshold during the put-right period. There are good grounds to sustain that this should be acceptable, including a 2010 CVM decision confirming that a private sale upon exercise of the put option during the put-right period shall be construed as a continuation of the transaction carried out on the stock market in which the price was determined. In this sense, legal scholar Nelson Eizirik understands that the acceptance ‘even if obtained after the tender offer, legitimates the approval of the redemption of the remaining minority shareholders’ shares’. Temas de direito societário; Nelson Eizirik; Ed. Renovar; Rio de Janeiro; 2005; p. 379.
distressed assets that tend to create optimal conditions for good M&A deals, especially for foreign players. This could arguably cancel out some of the negative effects of the crisis in the M&A market.

A number of market-oriented reforms passed over recent decades have consolidated a more investor-friendly and sound regulatory market infrastructure, including in the acquisition finance market. This has helped to improve foreign investment and further diversify the country’s investor base, helping Brazil to consolidate its economy’s position within the top 10 in the world. The warnings were everywhere that the increased level of government interference in the economy, including through the massive growth of lending in public sector banks and price controls, could snowball into a major crisis, and that is precisely what happened.47 Hopes are now high the new government’s strong economic team will be able to restart activity levels with a market-friendly toolkit legislative actions to further open the economy and less interference. As a part of this toolkit, the government has recently enacted the Declaration of Economic Freedom Rights. Announced as an effort to cut red tape in the Brazilian economy, Law 13,874 of 20 September 2019 put in place a set of principles aimed at assuring the free market status of the country’s economy. The declaration has also changed specific legal provisions to bring a forthright response and solution to chronic problems those doing business in Brazil have to grapple with routinely. The market has already priced the political mess, with some starting to argue that there is an interesting decoupling phenomenon in place: the economy will recover regardless of how chaotic the political arena is.

From the legal and regulatory standpoints, revamped due diligence and contractual terms, along with discussions around limitation of liability for acquisitions of assets from companies involved in corruption scandals, are hot topics in the legal community. Also, the economic crisis is putting the relatively young Bankruptcy Law into a forced stress test, with a number of restructuring procedures involving enormous companies (such as the judicial reorganisation of Oi, one of the largest telecoms providers in the country). For legal practitioners, the increasing stream of M&A opportunities within these procedures will be on the radar, as the market experiences a spike in financial sponsors focused on mandates for ‘special situations’ opportunities. From a tax standpoint, a favourable resolution of the ongoing tax controversy on the deductibility of acquisition-induced leverage may provide additional transparency and incentives for leveraged acquisitions in the Brazilian market.

47 ‘During the past decade, Brazil has achieved substantial progress in capital market development. The menu of available financial instruments has been expanded, market infrastructure has been reformed and strengthened, and a diversified investor base has been built. This was a high-priority agenda for the authorities, and the reforms were introduced in close cooperation with market participants. . . . Nonetheless, challenges remain and the continued development process will need careful management. Despite the country’s great potential (e.g., large size of economy, sound fiscal management, and large mutual fund industry), Brazil’s capital markets are still facing a number of challenges. These include still prevalent short-term indexation, investors’ risk aversion to long-term fixed rate bonds, still low liquidity in the secondary market, and managing the role of BNDES. A shift to a lower yield curve environment should continue to gradually take place. But further progress will require continued policy effort to assure macro stability and financial sector reforms to promote the development of longer-term private finance . . . It will also require close monitoring, to avoid a build-up of risks that could be engendered by the search for yield as the yield curve shifts down.’ Joonkyu Park, Brazil’s Capital Market: Current Status and Issues for Further Development, IMF Working Paper – September 2012.

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I OVERVIEW

Leveraged lending is frequently used by Canadian borrowers to fund a number of activities, including acquisitions, capital expenditures, dividend recapitalisations, refinancings of existing debt and ongoing operations. Recent acquisition activity in Canada has been relatively strong, and leveraged loans continue to be an important source of capital for many Canadian acquisitions. Continuing low interest rates, substantial liquidity in the North American market and the easing of credit terms have contributed to the attractiveness of leveraged loans for Canadian borrowers.

i Recent Canadian acquisition activity

The pace of mergers and acquisitions in Canada flourished in the fourth quarter of 2018, pushing M&A activity in Canada to a record annual high. There were 874 announcements in the fourth quarter, bringing the 2018 total number of announcements to 3,415, a 14 per cent increase from the 2,991 announcements made in 2017. There were 874 announcements valued at C$58 billion in the fourth quarter of 2018, a slight decrease compared to the 881 deals worth C$68 billion in the third quarter. The strength in activity in the fourth quarter was bolstered by a robust domestic merger and acquisition market, with 402 transactions involving Canadian buyers of domestic companies. There was also a sizeable increase in foreign acquisitions, with a record quarterly high of 281 announced in the fourth quarter, a 19 per cent increase from the third quarter. Real estate was the most active sector by deal volume, ending the year with a strong quarter of 114 announced transactions, a 27 per cent increase compared to the same period in 2017. The industrials sector notably experienced a 60 per cent increase in activity over the same quarter last year.

1 Jean E Anderson, David Nadler, Carrie B E Smit, David Wiseman and Caroline Descours are partners and Chris Payne is a senior associate at Goodmans LLP. Keyvan Nassiry is the founding partner of Nassiry Law, a Quebec firm based in Montreal.
2 Crosbie & Company, M&A Quarterly Canadian M&A Online: www.crosbieco.com/who-we-are/m-a-publications. Figures provided are a compilation from 2018 quarterly reports.
3 ibid.
4 ibid.
5 ibid.
6 ibid.
7 ibid.
Canada

represented 36 per cent of aggregate deal volume in the fourth quarter, primarily driven by the C$17.5 billion purchase of Johnson Controls’ Power Solution business by Caisse de dépôt et placement du Québec and Brookfield Business Partners.8

The surge in merger and acquisition activity continued into the first and second quarters of 2019, with 801 and 886 announced transactions respectively, the latter being the highest level ever.9 In the first quarter, the total deal value of C$74 billion was much higher than the first quarter of 2018 and at the high end of the range over the past seven years as a large number of mega deals (transactions with aggregate value in excess of C$1 billion) were announced.10 Total deal value decreased slightly to C$70 billion in the second quarter.11 This strong quarter is partly attributed to 13 mega deals. These mega deals had a total value of C$42.6 billion, down from 13 mega deals valued at C$59 billion in the first quarter and compared to the 18 mega deals valued at C$51 billion during the second quarter of 2018.12 The largest announced transaction was the C$7.7 billion acquisition of Merlin Entertainments, a UK based company, by a consortium of investors that included the Canadian Pension Plan Investment Board.13 The industrials sector was the most active sector, with 113 transactions valued at C$17.3 billion. The real estate sector was the second most active sector, with 110 transactions valued at C$12.5 billion in the quarter.14 Ontario currently remains the most active province for the quarter, with 236 deals valued at C$11.1 billion,15 and keeping in line with historical trends, outbound merger and acquisitions (transactions with Canadian buyers and foreign targets) outpaces inbound merger and acquisitions (foreign buyers and Canadian targets) by a ratio of 2:1.16 Overall, 2019 is on track to be a strong year for Canadian merger and acquisition activity.

ii Canadian financing sources

Canadian companies financed their acquisitions in recent months in a variety of ways. In many cases, a significant portion of the consideration for the acquisition was funded through various types of debt obtained from a variety of sources. Sources include senior secured credit facilities provided by domestic and foreign financial institutions, second-lien credit facilities, unsecured credit facilities, streaming arrangements, senior secured bonds, high-yield notes and mezzanine debt.

For example, Innergex Renewable Energy Inc financed its acquisition of 62 per cent of TransCanada Corporation’s co-ownership participation in five wind farms in Quebec, as well as TransCanada’s 50 per cent interest in Cartier Wind Farms’ operating entities, using two credit facilities.17 Stingray Digital Group Inc, a leading music, media, and technology company, financed its acquisition of Newfoundland Capital Corporation Limited through

8 ibid.
9 Crosbie & Company, M&A Quarterly Canadian M&A, online: www.crosbieco.com/who-we-are/m-a-publications. Figures provided are a compilation from 2019 quarterly reports.
10 ibid.
11 Crosbie & Company, note 9 at second quarterly report.
12 ibid.
13 ibid.
14 ibid.
15 ibid.
16 ibid.
a private placement of subscription receipts, a bought-deal public offering of subscription receipts, and an issuance of subscription receipts through the exercise of subscription rights financed by Investment Québec and Le Fonds de solidarité FTQ. Stingray also entered into new credit facilities for C$450 million with a syndicate of Canadian banks.18 AltaGas Ltd acquired WGL Holdings, Inc for approximately C$9 billion. This transaction was financed through a US$3 billion bridge facility, a C$2.6 billion bought deal offering of subscription receipts, and a C$400 million private placement of subscription receipts.19 Although these mentioned transactions represent only a fraction of the acquisitions recently done by Canadian companies, they provide good examples of highly leveraged financings for major acquisitions in Canada.

II REGULATORY AND TAX MATTERS

i Regulatory matters

Lender-related regulatory requirements

Canadian borrowers regularly obtain acquisition financing and leveraged finance products from a broad range of lenders including domestic and foreign financial institutions, private equity and hedge funds, and through the issuance of public debt, including high-yield debt. Canadian and foreign banks are very active in this area and provide a wide variety of debt products to Canadian borrowers. The key regulatory issue for lenders dealing with Canadian borrowers is whether the lender would be considered a bank for Canadian regulatory purposes. The activities of Canadian banks and foreign lenders affiliated with foreign banks that are carrying on banking business in Canada are subject to regulation under the federal Bank Act (Canada) (the Bank Act). Lenders that are banks or affiliated with foreign banks must obtain the necessary approvals under the Bank Act in order to establish a presence in Canada and must comply with the operational requirements of the Bank Act on an ongoing basis.

Foreign lenders affiliated with foreign banks that do not have a presence in Canada may lend to Canadian borrowers without obtaining regulatory approvals from federal banking regulators if the lending relationship is established in a way that would not involve the lender being viewed as carrying on business in Canada. Generally speaking, a loan that is made by a lender located outside of Canada and that is approved, negotiated and documented outside of Canada with payments being made to an entity outside of Canada should satisfy this test.

Absent connection with a bank, foreign and other lenders that are not otherwise regulated as financial institutions in Canada (e.g., insurance companies, trust companies and credit unions) do not require any special licences or regulatory approvals to make a loan to a Canadian borrower. These lenders will, however, be subject to laws of general application that apply to the taking and enforcement of security in certain provinces. For example, a lender may require an extra-provincial licence under provincial legislation to hold and enforce a

mortgage on real estate in that province. Lenders that lend on the security of real property may also need to obtain a mortgage brokerage licence under provincial legislation if they are not a financial institution exempted from compliance.

**Borrower-related regulatory requirements**

The activities of many Canada borrowers are subject to some degree of government regulation, and often a particular government licence or approval is a key component of the borrower’s business operations. Lenders to such borrowers should ensure that the borrower obtains all necessary governmental consents required to grant security on its assets to secure the proposed financing and to permit the lender to realise on its security. In addition, any transfer of a regulated borrower’s assets (including any applicable licences) as part of the realisation process may well require further governmental approvals, including approval of the proposed acquirer.

**Canadian anti-money laundering legislation**

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Canada) makes it mandatory for certain entities (including lenders) to undertake measures to ascertain the identity of Canadian borrowers and related parties before accepting them as clients, report a variety of transactions to the Financial Transactions and Reports Analysis Centre of Canada and to maintain certain client and transaction records. These requirements are designed to assist in the detection and deterrence of money laundering and the financing of terrorist activity in Canada and around the world. Lenders should ensure that their due diligence requirements include a request for the information necessary to ensure compliance with this legislation and that their borrowers covenant to provide this information on an ongoing basis.

**ii Tax matters**

Canadian tax issues must also be considered when structuring acquisition financing.

**Withholding tax**

Under the Income Tax Act (Canada) (Tax Act), interest paid by a Canadian resident debtor to an arm’s-length non-resident creditor will not generally be subject to Canadian withholding tax, provided that the interest is not participating (e.g., contingent or dependent on the use of or production from property in Canada or computed with reference to revenue, profit, cash flow, commodity price or similar criterion, or by reference to dividends paid). Where interest is subject to withholding tax under the provisions of the Tax Act (either because it is paid to a non-arm’s-length creditor or is participating), the terms of an applicable bilateral tax treaty may apply to reduce the rate of withholding tax from the Canadian domestic rate of 25 per cent. Under the provisions of the Canada–US Income Tax Treaty, the rate is reduced to 15 per cent if the interest is participating, or otherwise to zero per cent. Most other treaties reduce the rate of withholding tax on interest to 10 per cent.

**Interest deductibility**

Interest is only deductible to a Canadian resident debtor where it meets certain technical requirements set out in the Tax Act. In particular, interest (not in excess of a reasonable amount) is generally deductible on (1) borrowed money used for the purpose of earning income from a business or property; or (2) an amount payable for property that is acquired
for the purpose of gaining or producing income from a business or property. Interest payable on financing incurred to fund the acquisition of an asset to be used in the debtor’s business should generally be deductible. Similarly, interest payable on financing incurred to fund the acquisition of shares of a company (where there is a reasonable expectation of income from the shares) should also generally be deductible. Where the Canadian resident debtor incurs debt to finance the acquisition of shares, and it then amalgamates with, or winds up, the target company, the interest payable on that debt will generally continue to be deductible (on the basis that the income producing shares are now replaced with income-producing assets).

**Thin capitalisation rules**

Under the Tax Act, interest payable by a Canadian resident debtor may not be deductible to the debtor, and also may be subject to Canadian withholding tax on an accrual basis, if the Canadian thin capitalisation rules are applicable. These rules generally apply where (1) the creditor owns (or has a right to acquire) shares of the debtor representing 25 per cent or more of the votes or value of the debtor’s capital stock, and (2) the debt-to-equity ratio of the debtor with respect to such non-resident creditors is in excess of 1.5:1. The thin-capitalisation rules may apply in a situation where acquisition financing is undertaken by a non-resident parent corporation, which then on-loans the funds to its Canadian subsidiary, which acquires the target assets or shares.

**Consolidation issues**

Canadian resident corporations do not file consolidated tax returns (unlike in certain other jurisdictions, such as the United States). As a result, interest payable by a Canadian resident corporation is only deductible to that particular corporation and can only offset income earned by that particular corporation. Where the taxable income of the debtor corporation is not sufficient to offset the interest deductions, other transactions may need to be undertaken to efficiently use the interest deductions in the corporate group. In particular, when an acquirer incurs debt to finance the acquisition of a target corporation, additional steps (such as the amalgamation of the acquirer with the target) may need to be undertaken to facilitate the deduction of the interest on the acquisition financing against the target’s operating income.

**Stamp and documentary taxes**

There are no stamp or other documentary taxes in Canada to which loan or securitisation documentation or loan-trading documentation might be subject.

**Foreign Account Tax Compliance Act**

Under the US Foreign Account Tax Compliance Act (FATCA), payments made to foreign creditors under Canadian financing or leveraged finance arrangements may, in certain circumstances, be subject to a 30 per cent US withholding tax. Where there is a risk of FATCA withholding, the applicable loan or debt financing instrument will typically require the foreign creditor to provide such documentation as may be necessary for the debtor to comply with its obligations under FATCA and to determine whether the creditor has complied with its obligations under FATCA, or to determine the amount of FATCA withholding tax that will be deductible from payments made under the instrument. A Canadian debtor will typically not provide a gross-up to the foreign creditor for amounts deducted on account of FATCA withholding tax.
III SECURITY AND GUARANTEES

Secured loans are often used in Canada to finance acquisitions. The forms of security and guarantees most commonly used in the Canadian market to secure personal and real property assets, as well as the regime for taking security under the Civil Code of Quebec (CCQ) and the common law applicable in the other provinces and territories, are discussed below.20

i Security

Personal property and tangible movable property

Common law provinces

Each of the common law provinces and territories in Canada has a personal property security statute (collectively, PPSAs) that is modelled on Article 9 of the Uniform Commercial Code in the United States. Under the PPSAs, tangible movable property consists of goods, chattel paper, documents of title and investment property. In secured financings in the Canadian market, tangible movable property normally means goods that are equipment or inventory.

Security in this type of property is created when a debtor grants to the creditor a security interest in that property. The granting clause in the security agreement will expressly describe the collateral that the security interest attaches to. Quite often, secured creditors are given a general security interest that secures all of the debtor’s existing and after-acquired personal property, both tangible and intangible.

A security interest in tangible property must be perfected if a creditor is to have priority over the interests of other creditors and third parties. Registration of a financing statement in each province or territory where tangible assets are physically located is necessary to perfect a security interest in those assets. The PPSAs are publicly accessible, searchable databases, and a registered financing statement serves as notice that a debtor’s assets have been encumbered in favour of a secured creditor. Certain types of tangible personal property such as chattel paper, instruments, money, documents of title and large goods can also be perfected by possession.

Quebec

Security over tangible movable property in Quebec is created by a hypothec. Registration at the Register of Personal and Movable Real Rights (RPMRR) perfects the hypothec. No written agreement is needed where a hypothec is taken with delivery (i.e., a pledge). Perfection occurs when the pledged collateral is physically delivered to the pledgee.

Federal jurisdiction

Security in aircraft, ships and most railways is governed in Canada by federal legislation. While security interests in these types of assets can be taken under the PPSAs or the CCQ, secured parties are well advised to consider any applicable federal legislation and to take the additional steps prescribed therein to establish a first-ranking claim on such assets.

20 The common law provinces and territories in Canada are British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Nunavut, the Yukon Territories and the Northwest Territories.
**Personal property and intangible property**

*General – common law provinces*

Intangible personal property includes claims and receivables, intellectual property (IP) rights and investment property.\(^{21}\) Generally, creditors secure intangibles similarly to tangibles, by way of a security agreement and perfection by registration under the PPSAs.\(^{22}\) The law of the jurisdiction where the debtor is located\(^ {23}\) at the time the security interest attaches governs the validity, perfection and priority of a security interest in intangible personal property.

While IP ownership rights are governed by federal legislation in Canada, security in these intangibles is governed by the PPSAs. A security interest is created in IP rights through a grant of security under a security agreement and is perfected by registration. In addition, it is common practice for secured creditors with a security interest in Canadian intellectual property such as trademarks, copyright or patents to file a copy or notice of the security agreement with the Canadian Intellectual Property Office.

*General – Quebec*

Under the CCQ, the law of the jurisdiction where the grantor is domiciled (i.e., where its registered office is located) governs the validity and perfection of security over intangibles. Intangibles (incorporeal movable property) such as claims, receivables, contractual rights and IP rights owned by a debtor domiciled in Quebec are secured under the CCQ by way of a hypothec that is perfected by filing in the RPMRR. A hypothec on monetary claims is perfected by obtaining control over such claim (e.g., in the case of a deposit account, by the secured party entering into a control agreement with the financial institution holding the account).

**Investment property**

Financial assets such as shares and other securities are considered investment property under the PPSAs. All of the common law provinces and territories in Canada have a Securities Transfer Act or similar legislation (STAs) that is based on Revised Article 8 of the Uniform Commercial Code. The STAs work together with the PPSAs to govern the creation and perfection of security interests in investment property. The CCQ also contains provisions specific to investment property that are generally similar to STAs.

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21 The PPSAs expressly exclude an interest in or claim under any insurance policy or annuity contract from their scope. Secured debtors must take steps outside of the PPSAs to secure an interest in an insurance policy. The PPSAs do, however, provide that a previous security interest in other secured personal property assets extends to the proceeds of insurance on the assets. In Quebec, insurance policies can be charged by a hypothec (with a special perfection regime for hypothecs over life insurance policies).

22 Certain government receivables payable by the federal government of Canada and the provincial and territorial governments cannot be assigned or transferred as security unless secured parties comply with certain conditions prescribed by statute.

23 Generally, under the PPSAs, a debtor is located at its place of business or if a debtor has more than one place of business, where it has its chief executive office. In Ontario, however, deeming rules for determining a debtor’s location under the Personal Property Security Act (Ontario) became effective on 31 December 2015. The rules determine a debtor’s location based on what type of entity the debtor is. For example, provincial corporations are deemed to be located in the province or territory of incorporation or organisation.
Investment property under the PPSAs and STAs includes securities (uncertificated and certificated), securities entitlements, securities accounts, futures contracts and futures accounts. In secured financings in Canada, the type of investment property seen most commonly is certificated securities. A borrower or guarantor would typically pledge the certificated shares it holds directly in a subsidiary to a lender to secure its obligations owing to that lender.

In addition to execution of a security agreement and filing under the PPSAs to perfect an interest in investment property as an intangible, secured creditors can also establish ‘control’ or possession over such property. Control is the preferred method for perfecting such an interest as it gives the secured party a higher priority than a security interest perfected by registration alone.

Where investment property is held directly by a debtor, a secured party obtains control of certificated securities by taking possession of the certificates and either taking an endorsement or having the securities registered in its name. For uncertificated securities, control is achieved by either registering the securities in the name of the secured party or by obtaining a control agreement from the issuer of the securities. A control agreement is a tripartite agreement among the issuer, the debtor and the secured party and provides that the issuer agrees to comply with instructions from the secured party with respect to the securities without the debtor’s further consent.

Where the investment property consists of securities entitlements held indirectly by the debtor through a securities intermediary, the secured party obtains control by arranging for the securities intermediary to record the secured party as the entitlement holder; obtaining a control agreement from the securities intermediary; or having a third party obtain control on its behalf.

**Real property**

The most common forms of security over real estate in the Canadian market are mortgages, debentures, hypothecs and trust deeds. Real estate in the common law provinces and territories includes land (together with buildings and fixtures), airspace above land, crops, forests, non-navigable waters, easements, sub-surface land rights, rental income and other profits derived from land and leasehold interests. Real estate under the CCQ includes land, any constructions and works of a permanent nature located on the land and anything forming an integral part of the land, plants and minerals that are not separated or extracted from the land, personal property that is permanently physically attached and joined to an immovable and that ensures its utility and real rights in immovable property, as well as actions to assert these rights or to obtain possession of immovables. Each province and territory in Canada has a real property title registration system. Secured creditors perfect interests in real property by filing their mortgage, debenture, hypothec or trust deed against the title to the debtor’s real property. There are some special statutes in Canada that govern most federally regulated facilities such as airports, prisons and major shipping ports, and these should be assessed when taking security involving these types of facilities.

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24 For example, a clearing house, retail investment broker or bank.
Guarantees

Guarantees are a common feature of secured lending structures for acquisition and other types of financings in the Canadian market. Typically, a guarantor (e.g., a parent or corporate affiliate of the borrower) will enter into a stand-alone guarantee with a lender that guarantees the obligations of the borrower to the lender. In the acquisition context, it is not uncommon for the obligations of a sole-purpose acquisition entity to be guaranteed by an equity sponsor or controlling parent company. In Quebec, suretyships are used frequently in secured lending.

Guarantee limitations

Financial assistance

Corporate assistance legislation in Canada has eliminated outright restrictions on financial assistance. It is permitted without restrictions of any kind in several provinces, including Ontario and Nova Scotia. In other provinces and territories, financial assistance is also permitted generally but is subject to a solvency test or disclosure requirements. This more relaxed regime has provided increased flexibility to lenders in Canada when structuring security packages that include guarantees.

Corporate benefit

There is no corporate benefit requirement under Canadian corporate law statutes. However, a financing transaction that does not provide any apparent benefit to a corporation may be challenged as oppressive by creditors or minority shareholders or may result in an allegation that the fiduciary duties of the corporate directors approving the transaction have been breached. Guarantees supporting the debt of affiliated entities are generally enforceable and valid in Canada as long as the debt is of benefit to the corporate group as a whole.

Agency concept

Except for Quebec, the concept of agency has long been recognised in all Canadian jurisdictions and is commonly used in secured loan structures in Canada. Agents are often used to represent lenders in a syndicate or to hold collateral on behalf of lenders.

Until recently, the concept of holding security for others was not clear under Quebec law. Most lending lawyers in Quebec had taken the view that an agent had to be formally appointed as a person holding the lenders’ power of attorney to hold a hypothec without delivery on behalf of future, unknown members of a syndicate of lenders. Revised Article 2692 of the CCQ clarifies this uncertainty. Under revised Article 2692, a hypothec may be granted to a ‘hypothecary representative’ for all present and future creditors of the obligations secured by that hypothec. This clarification has been well received in the Canadian market.

Challenging security under Canadian law

Under Canadian law, there are several ways that a creditor or court-appointed officer could challenge security both before or after the commencement of insolvency or restructuring proceedings. Remedies for ‘reviewable transactions’ are available under federal insolvency legislation and provincial legislation.
In the context of insolvency proceedings, a trustee in bankruptcy can challenge preferences and other transactions at undervalue under the federal Bankruptcy and Insolvency Act (BIA). Under Section 95 of the BIA, a trustee in bankruptcy can challenge a preference, namely a transaction with a debtor or payment made by a debtor that has the effect of preferring one creditor over another and that was entered into within prescribed time periods before insolvency proceedings in respect of the debtor were commenced. If the preference is proven, the transaction or payment is void against the trustee in bankruptcy. Under Section 96 of the BIA, a trustee in bankruptcy can attack transactions between the debtor and persons who gave inadequate consideration for assets, goods or services provided by the debtor within prescribed time periods before insolvency proceedings in respect of the debtor were commenced. Courts can order that transfers at undervalue are void against the trustee in bankruptcy or, alternatively, that the parties to the transfer pay to the debtor’s estate the difference between the consideration received by the debtor and the consideration given by the debtor. To the extent that transactions are rendered void as against a trustee in bankruptcy and the property in question has been further transferred, the BIA provides that the proceeds from the transfer of the property shall be deemed to be the property of the trustee. These sections of the BIA also apply (with any necessary modifications) to proceedings under Canada's other major insolvency and restructuring statute, the Companies’ Creditors Arrangement Act (CCAA).

Provincial legislation is also available to creditors or trustees to attack preferential transactions. While there are differences among the various provincial statutes, most provinces allow a creditor to attack fraudulent conveyances and unjust preferences. In general terms, fraudulent conveyances are transactions where conveyances of real or personal property are made with the intent to defeat, hinder, delay or defraud creditors or others. Unjust preferences are preferential payments or transactions made when the debtor was in insolvent circumstances, unable to pay its debts or knew it was on the brink of insolvency. Transactions found to be fraudulent conveyances or unjust preferences can be voided as against creditors.

Finally, in almost all Canadian provinces and territories, creditors may use the oppression remedy under corporate law to challenge security given by a corporation. This would involve a transaction where the corporation or its directors effected a result or acted in a manner that was oppressive, unfairly prejudicial to or unfairly disregarded the interests of certain parties (including creditors). Where oppressive conduct is found, Canadian courts have broad discretion to grant any remedy they deem appropriate in the circumstances.

25 Where a trustee refuses or neglects to take proceedings after being requested to do so by a creditor, that creditor may make an application to the court for an order authorising it to take the proceedings in question in its own name and at its own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

26 In which case, a CCAA court-appointed monitor could challenge preferences and other transactions at undervalue. See Section 36.1(1) of the CCAA.

27 Court-appointed officers and other parties seeking to challenge a transaction or grant of security may rely on these provincial statutes both within insolvency proceedings under the BIA or CCAA and outside the proceedings.
IV  PRIORITY OF CLAIMS

i  Priority claims

In Canada, the priority of a claim of a creditor of an insolvent corporation will depend upon the nature of the claim and the insolvency proceedings applicable to the borrower. The enforcement of security may occur in the context of a proceeding under the CCAA or the BIA. An insolvent corporate borrower may reorganise itself under the CCAA or BIA or petition itself into bankruptcy under the BIA.

In a Canadian insolvency proceeding, certain claims may be afforded priority over a secured lender pursuant to a court order and the priority of these claims will be determined by the court based on the facts of each case. The court may, for example, grant a charge in priority to the security of existing lenders in the debtor’s assets to secure, among other things, claims of, or in respect of, critical suppliers, debtor-in-possession lenders, directors’ corporate indemnities, key employee retention payments and professional administration fees.

In addition, certain statutory charges will continue to have priority over a secured lender’s claim in a bankruptcy, including, among others, claims for unremitted employee source deductions, certain employee claims that are paid by the Canadian federal government under the Wage Earner Protection Act and certain employee and employer pension plan contributions that are due and unpaid. In a CCAA restructuring or BIA proposal, generally speaking, the restructuring plan or proposal for the insolvent borrower must provide for the payment of certain employee and other claims unless otherwise agreed by the relevant parties. Notably, a number of the Canadian federal and provincial statutory deemed trusts and charges that can prime a lender’s security outside a bankruptcy for unpaid amounts, such as vacation pay and sales tax, would be reversed in a bankruptcy of the insolvent borrower.28 This might not be the case, however, where a statutory trust satisfies the general principles of trust law for creating a true trust, in which case the assets impressed with the trust would be excluded from any distribution to the insolvent borrower’s secured creditors.29

As noted above, certain pension claims may rank in priority to a lender’s security in the event of a borrower’s insolvency. The Supreme Court of Canada decision in Indalex Limited (Re),30 however, created some doubt as to the priority afforded to the amount of any funding deficiency arising in connection with the wind-up (a wind-up deficiency) of a borrower’s defined benefit pension plan. Prior to this decision, it was generally thought that the deemed trust provisions of the applicable pension legislation would not apply to a wind-up deficiency. Although the Supreme Court made it clear that a deemed trust could apply to a wind-up deficiency, and that the claim for such amount would be subordinate to a court-ordered charge securing debtor-in-possession financing for the insolvent borrower, the Court did not opine on the relative priority of liens on the accounts receivable and inventory securing

28 In Callidus Capital Corp v. Canada, 2018 SCC 47, the Supreme Court of Canada denied a taxing authority’s efforts to have its deemed trust for unremitted taxes upheld as against a secured creditor who, before the insolvent debtor’s bankruptcy, received proceeds from the insolvent debtor that were deemed to be held in trust for the taxing authority.

29 In a recent case, The Guarantee Company of North America v. Royal Bank of Canada, 2019 ONCA 9, the Ontario Court of Appeal held that Ontario’s Construction Lien Act impresses a true trust on the funds owing to or received by a bankrupt contractor, preserving those assets from distribution to the bankrupt contractor’s creditors.

30 2013 SCC 6 (Indalex).
indebtedness existing at the time a CCAA order is made. Lenders providing financing to a Canadian borrower that has a defined benefit plan registered in Canada or to acquire a target with such a plan should determine whether a deemed trust could apply to a wind-up deficiency under the applicable pension legislation and consider the impact on their security position in the event of an insolvency.

Lenders should also be aware of a notable decision of the Supreme Court of Canada, Orphan Well Association, et al. v. Grant Thornton Limited et. al. (a.k.a. Redwater), which considered Alberta’s provincial regulatory regime regarding abandonment and reclamation obligations (or end-of-life obligations with respect to abandoned oil wells). The Alberta Energy Regulator issued orders under the provincial regulatory regime requiring Redwater Energy Corporation, an insolvent oil and gas company, to fulfil its end-of-life obligations.

The question before the Supreme Court in Redwater was whether the Alberta Energy Regulator’s use of powers under Alberta’s provincial legislation to enforce compliance with end-of-life obligations could be enforced in insolvency and whether those powers conflict with the trustee in bankruptcy’s powers under the BIA or with the order of creditor priorities prescribed by the BIA. If so, the provincial regulatory regime would be inoperative to the extent of the conflict by virtue of the doctrine of federal paramountcy.

The majority of the Supreme Court held that, for a number of reasons, the Regulator’s use of its provincial statutory powers does not create a conflict with the BIA and, therefore, does not trigger the doctrine of federal paramountcy. This meant that the Alberta regime, which was binding on receivers and trustees, could be enforced against Redwater’s trustee in bankruptcy such that Redwater’s end-of-life obligations for its inactive oil and gas wells were to be satisfied from the insolvent estate, notwithstanding the impact on secured lender recovery.

Lenders will want to ensure they understand the applicable provincial regulatory regime, and its application in a potential insolvency, as well as ensure that lending values account for such risks where a Canadian borrower has potential environmental liabilities.

ii Equitable subordination

Under the US Bankruptcy Code, the doctrine of equitable subordination allows courts to subordinate creditor claims to those of lower-ranking creditors. This extraordinary remedy is typically reserved for situations of egregious conduct on the part of creditors, because it

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31 See also Grant Forest Products Inc v. The Toronto-Dominion Bank, 2015 ONCA 570 (Grant Forest). In Grant Forest, the Ontario Court of Appeal confirmed that a judge presiding over CCAA proceedings has the discretion to permit a creditor to petition the debtor company into bankruptcy, even when the transition to bankruptcy results in a loss of the pension deemed trust and an altering of priorities in favour of a secured creditor. In addition, the Ontario Court of Appeal, although not explicitly upholding the ruling of the lower court that a wind-up deemed trust does not prevail when a wind-up is ordered after the commencement of CCAA proceedings, did distinguish the facts from the Indalex case (the wind-up deemed trust under consideration in Indalex arose before the CCAA proceedings commenced, whereas in Grant Forest, neither of the pension plans were wound up until after the CCAA proceedings commenced).

32 2019 SCC 5.

33 These obligations refer generally to responsibilities for plugging and capping oil wells to prevent leaks, dismantling surface structures and restoring the surface to its previous condition.

34 The doctrine of federal paramountcy establishes that where there is a conflict between valid provincial and federal laws, the federal law will prevail and the provincial law will be inoperative to the extent it conflicts with the federal law.
supplants negotiated contractual arrangements between parties. For a claimant to succeed in subordinating a creditor claim, it must demonstrate that the creditor engaged in inequitable conduct, that the conduct harmed other creditors of the bankrupt company or conferred upon the creditor an unfair advantage, and that the subordination is consistent with the remainder of the US Bankruptcy Code.

Although there is no equivalent legislative provision in Canada, recent decisions by Canadian courts have suggested that the doctrine of equitable subordination could potentially be adopted in certain circumstances. In *Indalex*, the Supreme Court of Canada affirmed the ‘wait and see’ approach it espoused in *Canada Deposit Insurance Corp v. Canadian Commercial Bank*, whereby rather than ruling one way on the doctrine’s applicability, it declared that the facts at hand did not give rise to a claim for equitable subordination and left its determination for a later date. Subsequently, in its recent decision in *US Steel Canada Inc (Re)*, the Ontario Court of Appeal ruled that the CCAA court does not have the jurisdiction under the CCAA to grant the remedy of equitable subordination. The Ontario Court of Appeal, however, left the door open for equitable subordination to apply in a BIA context on the basis that the BIA provides the court with express jurisdiction in equity. Leave to appeal to the Supreme Court of Canada was granted in respect of the Ontario Court of Appeal’s decision in *US Steel*; however, the appeal was discontinued and the Ontario Court of Appeal decision remains the authority in Canada.

### iii Second lien financings

As noted above, a Canadian borrower may incorporate several different types of indebtedness (including second lien loans) in its capital structure. Second lien loans are an increasingly popular source of financing in Canada for acquisitions, recapitalisations and restructurings. Non-bank entities such as hedge funds, private equity funds and distressed debt funds, particularly those based in the United States, are typically the providers of second lien loans to Canadian borrowers. As second lien loans are secured by a lien on all or a portion of the borrower’s assets, these loans are generally considered to be a lower risk alternative to mezzanine loans and, accordingly, are less costly than mezzanine or other junior unsecured debt. In addition, as a result of investor demand for the enhanced yields available through leveraged products, second lien loan terms have become more debtor-friendly and a number of borrowers have been able to obtain covenant-lite loans. Often these loans are provided in US dollars so are particularly attractive to Canadian borrowers with significant US-dollar cash flows that provide a natural hedge to currency exchange fluctuations that could otherwise affect their ability to make loan payments in US dollars.

The respective rights of the first lien lenders and the second lien lenders will be set forth in an intercreditor agreement. A first lien-second lien intercreditor agreement will certainly include a contractual subordination of the second lien lender’s claim to the rights of the first lien lender and restrictions on the ability of the second lien lender to enforce its lien against the common collateral for the loans. The intercreditor agreement may also include provisions addressing the issues set out below.

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35 20 [1992] 3 SCR 558, paragraph 44.
36 *Indalex*, note 29 at paragraph 77.
37 2016 ONCA 662 (*US Steel*).
iv Intercreditor agreements

Lenders have made a broad variety of debt products available to borrowers to finance their operations, acquisitions and other activities. As a result, many borrowers have complex capital structures with several layers of debt secured by liens on the same collateral. For example, a borrower may have a senior term and operating credit facility, hedging obligations, cash management obligations and a second lien term loan or notes secured by liens on the borrower’s assets. Lenders in these circumstances will typically enter into an intercreditor agreement that delineates their respective rights, remedies and priorities, particularly in a default situation. Canadian courts will generally treat an intercreditor agreement as an enforceable contract between the lenders and uphold its provisions. However, if the borrower in question is subject to an insolvency proceeding, it is possible that the court supervising the proceeding may make an order that is not consistent with the provisions of the applicable intercreditor agreement in exercising its jurisdiction over the matter.

The terms of any particular intercreditor agreement will be influenced by the borrower’s creditworthiness and capital structure, the type and terms of the relevant debt, the lenders’ preferred exit strategies and the general economic environment. The primary purpose of an intercreditor agreement from a senior lender’s perspective is to ensure that it is in a position to control the enforcement proceedings with respect to a defaulting borrower until the senior lender is repaid in full or is no longer prepared to continue. Intercreditor agreements also typically include provisions that deal with:

\( a \) the relative priority of liens on the collateral;
\( b \) the application and turnover of proceeds derived from the collateral, payment restrictions or blockage periods with respect to junior debt payments;
\( c \) restrictions on the type and amount of senior debt that ranks prior to more junior debt;
\( d \) standstill periods and other restrictions on enforcement proceedings by holders of junior debt;
\( e \) access rights to certain collateral;
\( f \) restrictions on certain modifications to the terms of each lender’s credit documentation;
\( g \) refinancing rights; and
\( h \) the right of junior debt holders to purchase the senior debt.

Triggers for junior debt payment blockages, the frequency and length of payment blockage periods as well as the right to make catch-up payments once a payment blockage has ceased are often heavily negotiated. The elements and amount of senior debt (including interest rate and fee increases, over-advances, prepayment premiums and hedging obligations) that ranks in priority to the junior secured debt are also frequently the subject of much discussion.

V JURISDICTION

It is not uncommon for acquisitions in Canada to be financed by foreign lenders based in financial centres such as New York or London. This occurs most often when the buyer is foreign or the Canadian target is part of a larger cross-border or international corporate structure. Foreign lenders often expressly choose to have their principal financing agreement governed by the law of their home jurisdiction and to stipulate that any resulting disputes will be governed by that law. In these circumstances, foreign lenders need to understand how choice of law and foreign judgments are treated in Canada and whether consent to jurisdiction clauses are enforceable.
i  **Choice of law**

Generally speaking, in a proceeding in Canada to enforce a foreign law-governed document, Canadian courts will, with limited exceptions, apply the law expressly chosen by the parties, as long as the choice of the foreign law in the agreement is bona fide, legal and not contrary to public policy. Canadian courts will apply local law to procedural matters and apply local laws that have overriding effect. In addition, Canadian courts will not apply foreign law if to do so would have the effect of enforcing a foreign revenue, expropriation or penal law.

In the unlikely event that the parties do not expressly choose a system of law to govern the primary financing agreement, Canadian courts will apply the law that has the closest and most real and substantial connection to the agreement.

ii  **Enforcement of foreign judgments**

Without reconsidering the merits, and subject to certain defences, Canadian courts generally will issue judgments in Canadian dollars based on final and conclusive foreign judgments rendered against the person for a specified amount if the action in Canada is brought within any applicable limitation period. Under certain circumstances, our courts have the discretion to stay or decline to hear an action based on a foreign judgment. Such actions may also be affected in the courts by bankruptcy, insolvency or other similar laws affecting creditors’ rights.

Certain defences are available to debtors in Canada to prevent recognition and enforcement of a foreign judgment against them. The foreign judgment cannot have been obtained by fraud or in a manner contrary to natural justice. In addition, the foreign judgment cannot be for a claim that under Canadian law would be characterised as being based on a revenue, expropriatory or penal law; nor can the foreign judgment be contrary to public policy. Finally, our courts will not enforce the foreign judgment if it has already been satisfied or is void or voidable under the foreign law.

iii  **Submission to jurisdiction clauses**

Agreements to submit all disputes related to the financing transaction to a specified jurisdiction are common in commercial financing agreements, and can be exclusive or non-exclusive. Under Canadian law, non-exclusive jurisdiction clauses have historically been held to be enforceable. Recent Canadian case law, including decisions from the Supreme Court of Canada, has strongly supported enforcement of exclusive jurisdiction clauses in order to increase predictability and certainty in the Canadian market.

VI  **ACQUISITIONS OF PUBLIC COMPANIES**

In Canada, acquisitions of public companies are generally implemented through (1) takeover bids pursuant to which the acquirer bids for the shares of the target (and which may or may not be followed by a compulsory acquisition of those shares that are not tendered into the bid or a second stage going private transaction); (2) a plan of arrangement (whereby a solvent company can pursue a broad range of fundamental changes under a single transaction that is court approved); or (3) an amalgamation of the target company with the acquirer. In Canada, acquisitions of public companies are generally effected by way of a takeover bid or plan of arrangement.
In each of the foregoing cases, where the consideration to be paid for the shares of the target will be satisfied in whole or in part in cash, an acquirer will generally incur as much debt as possible (often using the assets and credit rating of the target company as collateral) to finance the going private transaction. While, in recent years, the availability of financing has been restricted, there is now a resurgence in acquisitions being financed by more significant amounts of debt and a rejuvenation of the highly leveraged buyout market.

There are several issues that are unique to the financing of acquisitions of public companies in Canada. While many of these issues vary based on the specific provincial corporate and securities laws that are applicable in any given transaction, the general approach and issues raised are common in all Canadian jurisdictions.\(^38\)

i Conditionality and certainty of funds

Canadian securities laws establish a ‘certainty of funds’ requirement for takeover bids of Canadian public companies. In this regard, Section 2.27 of National Instrument 62-104 (Take-Over Bids and Issuer Bids) states that where a bid provides that the consideration for the securities deposited under such bid is to be paid, in whole or in part, in cash, ‘the offeror must make adequate arrangements before the bid to ensure that the required funds are available to make full payment for the securities that the offeror has offered to acquire’.\(^39\)

In addition, the financing arrangements can be subject to conditions only if, at the time the bid is commenced, ‘the offeror reasonably believes the possibility to be remote that, if the conditions of the bid are satisfied or waived, the offeror will be unable to pay for the securities deposited under the bid due to a financing condition not being satisfied’.\(^40\)

In practice, the ‘adequate arrangement’ test will generally be satisfied by the offeror obtaining a binding commitment letter from its financing source that contains only limited customary conditions. Conditions that are viewed as generally being acceptable include those that mirror the conditions in favour of the offeror contained in the bid documents or that are otherwise reasonably easy for the offeror to satisfy (such as the completion of a definitive credit agreement and related loan documents). Conditions that would be unacceptable in this context would include conditions that are in the discretion of the lenders, such as satisfactory due diligence or satisfaction with the capitalisation or ownership of the target following completion of the bid.

ii Two-stage transaction

Generally, acquisition financings are secured by, inter alia, the collateral of the target company. In fact, the credit rating and the value of the assets owned by the target company are significant components in the lenders’ analysis of the amount of credit they are willing to provide to finance an acquisition. In connection with an acquisition where the offeror aims to acquire all of the outstanding shares of the target company, the minimum tender condition is generally set at 66\(\frac{2}{3}\) per cent (75 per cent for some jurisdictions). This allows the offeror to achieve a certain level of security regarding the outcome of the bid.

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38 We have focused on the laws of the province of Ontario in our analysis of these issues below.

39 National Instrument 62-104 - (Take-Over Bids and Issuer Bids) (2016), 39 OSCB (Supp-1) 63, Section 2.27(1).

40 National Instrument 62-104 - (Take-Over Bids and Issuer Bids) (2016), 39 OSCB (Supp-1) 63, Section 2.27(2).
If an offeror acquires more than 90 per cent of the securities subject to the bid (excluding those previously held by it), both Canadian federal and provincial legislation provides for a procedure for the compulsory acquisition of the balance of the shares within a certain period of time. In the event less than 90 per cent but more than 66 2/3 per cent (75 per cent for some jurisdictions) of the outstanding securities are acquired, the offeror can complete the acquisition of 100 per cent of the securities of the target company by means of a subsequent going private transaction. In this circumstance, the offeror can vote the shares that were tendered to it under the bid. Since the voting threshold under applicable law for approval of a going-private transaction is 66 2/3 per cent (75 per cent for some jurisdictions) of the shares voting at the shareholders’ meeting called to approve the transaction, the offeror can be assured that the transaction will be approved.

The foregoing has a direct impact on a lender’s ability to take security over the assets of the target company. This security cannot be granted until the offeror acquires 100 per cent of the shares of the target. The lenders will have to advance funds under the credit agreement at such time as the minimum bid condition is satisfied to enable the offeror to acquire the number of securities tendered but before it is able to obtain a security interest in the assets of the target. However, it is essentially a certainty that once such minimum number of shares is tendered to the bid, the offeror will be able to acquire 100 per cent of the target in due course.

### Disclosure requirements

There are disclosure requirements under Canadian securities laws with respect to the terms of a financing related to the acquisition of a public company. In the context of a takeover bid where a financing is involved, the takeover bid circular must state the name of the lender, the terms and conditions precedent to the financing, the circumstances under which the loan must be repaid and the proposed method of repayment. These disclosure requirements are easily satisfied by including a summary of the terms and conditions of the financing in the circular, which must be in the form prescribed.

### VII OUTLOOK

Secured debt continues to be a popular source of funds for Canadian borrowers although lending activity is somewhat volatile. Canadian borrowers are continuing to take advantage of relatively low interest rates, market liquidity and favourable financing terms by securing debt financing to fund acquisitions, the refinancing of existing debt with more onerous terms, dividend and other balance sheet restructurings. In addition, we expect that the trend of Canadian borrowers amending (including repricing) and extending their credit facilities prior to maturity will continue given the favourable conditions in the Canadian debt market including falling interest rates.

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41 National Instrument 62-104 - (Take-Over Bids and Issuer Bids), Form 62-104F1 – Take-Over Bid Circular at item 12.

42 See prescribed form in National Instrument 62-104 - (Take-Over Bids and Issuer Bids), Form 62-104F2 – Issuer Bid Circular.
The high-yield market in Canada has been a difficult one for borrowers for the past couple of years, with a limited number of Canadian dollar-denominated high-yield note issuances being completed. As a result, Canadian borrowers are increasingly turning to the US high-yield market to raise funds and are generally finding that they must pay a premium compared with US borrowers in that market for their offerings to be successful.

As US sponsors become more active in Canada and seek financing from Canadian lenders for their Canadian acquisitions, covenant-lite loans are becoming more common in Canada. Covenant-lite loans generally do not include financial maintenance covenants or include them only on a springing basis based on certain leverage levels. Equity cures of financial covenant breaches are generally permitted. As financial covenant breach is often an early indicator of financial difficulty, the downside for lenders is that they may not be able to trigger a default based on a financial covenant breach and initiate restructuring discussions at an early stage when more options are available to address the borrower’s financial issues.

Unitranche lending has also gained some popularity with Canadian borrowers, particularly those exposed to US lenders through their US affiliates. Unitranche facilities combine senior and junior debt into one credit facility with the lenders addressing their respective priorities with a first-out, last-out mechanism under an agreement among lenders.
Chapter 7

CHINA

Jie Chai, Qin Ma and Xiong Yin

I

OVERVIEW

Domestic and international banks are the primary source of debt finance in acquisition transactions. Finance companies also play an important role in the debt financing market. Unsecured credit facility, secured facility, revolving facility for working capital purposes, bonds and convertible bonds are the most commonly used debt products. Chinese laws are not well developed for the mezzanine finance; however, mezzanine finance is not a new concept in China as it is commonly seen for Chinese companies with an offshore structure. For onshore companies, hybrid debt-plus-securities instruments are commonly arranged, under which companies can issue securities backed by credit assets consisting of the debts arising out of a number of loans of multiple borrowers in the national inter-bank bond market or stock exchanges, and the qualified investors thus may be able to negotiate and trade such securities. Information regarding debts in the asset pool of the securities should be disclosed, including the names of the borrowers and the loan agreements.

II

REGULATORY AND TAX MATTERS

In China, an entity can only conduct lending business after obtaining the permit or approval by the People’s Bank of China, China Banking and Insurance Regulatory Commission (CBIRC) or other competent governmental authorities. Major market players in the debt financing industry are commercial banks, policy-oriented banks, lending companies and micro-lending companies, which should conduct business according to the applicable laws and regulations.

i

Acquisition finance

Commercial banks, policy-oriented banks, Chinese branches of foreign banks, finance companies of enterprise groups, while conducting their acquisition finance business, should comply with the Guidelines for Risk Management of Acquisition Financing by Commercial Banks (the Guidelines) promulgated by the CBIRC. According to the Guidelines, the financing amount may not exceed 60 per cent of the total acquisition price of a transaction and the term of the loan may not exceed seven years.

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1 Xiong Yin and Jie Chai are senior partners and Qin Ma is a senior associate at Tian Yuan Law Firm.
According to the Guidelines, a lender conducting acquisition financing business should meet the following requirements: (1) have sound risk management and an efficient internal control mechanism; (2) its capital adequacy ratio is not less than 10 per cent; (3) all of its other regulatory indices meet applicable regulatory requirement; and (4) have a professional team to conduct the due diligence and risk assessment of acquisition financing.

The Guidelines also set forth the requirement for the acquisition financier to maintain the internal control and risk management system, including: (1) its aggregate outstanding amount of acquisition financing not exceeding its net tier-1 capital for the same period, and its aggregate outstanding amount of acquisition financing to a single borrower not exceeding 5 per cent of the net tier-1 capital for the same period; (2) assessing the strategic, legal, regulatory, concentration, business, financial and regulatory risks of an acquisition transaction; (3) reporting to CBIRC the concentration limit on a per-borrower, group customer, industrial, national or jurisdictional basis; (4) ascertaining the leveraged ratio of acquisition financing and ensuring reasonable funding by equity contribution; (5) strengthened due diligence and after lending loan management and supervision; and (6) mandatory provisions in the facility agreement to protect the lender’s right, such as the provisions on the lender’s right to take risk control measures upon occurrence of material adverse change in the target group and the equity funding as a condition precedent to the disbursement of the acquisition financing.

ii Syndicated loan

The Guidelines for Syndicated Loan Business (the Syndication Guidelines) promulgated by CBIRC are the primary regulations on the syndicated loan business, which stipulate the rights and responsibilities of the lead bank, agent bank and participating bank, form of syndication and documentation requirement. If a single bank acts as the lead bank, its commitments should be not less than 20 per cent of the total commitment, and the participating shares of the other members should not be less than 50 per cent of the total commitment.

iii Anti-money Laundering and anti-corruption compliance

The Anti-Money Laundering Law and the Provisions on Anti-Money Laundering of Financial Institutions stipulate the detailed requirement for the financial institutions and certain non-financial institutions to comply with the anti-money laundering obligation, including identifying a client’s identity, preservation of information of the clients and transactions and reporting large-amount transactions or dubious transactions.

In 2017, the People's Bank of China issued a notice to strengthen the scrutiny of identification of a client’s identity so as to fight against money laundering and terrorism financing. In the event that the client is a non-individual entity, a financial institution is required to investigate, record and report the current shareholding structure and any change thereof and information on the ultimate parent shareholder and senior management officers. The notice also provides the guidance for strengthening scrutiny if the client is a sensitive individual (e.g., foreign political dignitary, member of senior management of an international organisation or individual beneficially owning the interest of the non-individual client), or is involved in certain type of business relationship (e.g., a client from a high-risk district or countries as identified by FATF, EAG, APG or other international anti-money laundering institutions).

Anti-corruption is largely stipulated in China’s Criminal Law, Anti-Unfair Competition Law and related regulations. There is no legislative guidance specifically applicable to the financial institutions regarding administration of anti-corruption matters.
iv Tax

Total interest income is taxable income, and unless otherwise stipulated by law, the taxable income of the enterprises is generally subject to 25 per cent of the corporate income tax in China. The overseas branch office (with no legal person status) of a Chinese resident bank is considered as a resident of China for tax purposes. The income of the overseas branch office is taxable together with its head office, and no withholding tax is payable for the interest paid from a domestic institution to the overseas branch office, provided that, if the overseas branch collects the interest on behalf of a non-Chinese resident, the domestic enterprise is obligated to withhold income tax for the interest paid to the overseas branch. If the actual management organ of a Chinese enterprise’s overseas subsidiary is located in China, the overseas subsidiary will be considered as a Chinese resident as well.

Interest expenses are deductible against operating income of the borrower.

The financial institutions are subject to a 6 per cent VAT for the income accrued from the debt financing; if, however, a financial institution is recognised as small-sized taxpayer, the VAT rate is 3 per cent. VAT exemption is granted if the loan is made to small enterprises, micro enterprises or a self-employed household.

Unless otherwise stipulated in the tax treaties or other tax preferential treatment, a Chinese resident borrower should withhold the corporate income tax at the rate of 10 per cent for the interest paid to the non-resident lender.

III SECURITY AND GUARANTEES

The types of security under PRC laws include mortgage, pledge, guarantee and lien, among which the security package most commonly used in the acquisition finance transaction are share pledge, cash deposit, corporate or personal guarantee or combination of the foregoing. Mortgage of real estate (including land use right) of great value is also commonly seen, but the practice of registration varies according to different local governmental authorities; mortgages may not be registered in some areas if the beneficiary is a non-bank lender.

Grant of cross-border security or guarantee is subject to the administration of the State Administration of Foreign Exchange (SAFE); for example, the provision of guarantee or security by an onshore non-bank entity in favour of an overseas entity securing the debt of an overseas debtor should be registered with SAFE after the execution of security documents.

In the case of listed company takeover, the listed company should not provide any form of financial assistance to the acquirer, or any security in favour of the acquirer or its affiliate.

Security is irrevocable if it is granted within one year of the court accepting a bankruptcy application with respect to the security provider in order to secure an unsecured debt.

IV PRIORITY OF CLAIMS

Secured claims should be repaid in priority from the proceeds of the secured assets. After full repayment of the secured claims, the remaining amount of the proceeds of the secured assets (if any) will be considered as the bankruptcy assets.

Other claims should be paid in the following orders from the bankruptcy assets:

a administrative fees and expenses in connection with the bankruptcy proceeding, and debts incurred for the common good of creditors after initiation of bankruptcy proceeding;
wages, subsidies for medical treatment, injuries and disability, and the pensions for the disabled and the families of the deceased that the debtor owes, the basic health and pension benefits that should have been paid to the employees’ personal accounts, and other compensations that should have been paid to the employees as prescribed by law and regulations;

c other social insurance premiums and tax that the bankrupt fails to pay; and

d unsecured bankrupt claims.

In China, subordinated bonds can only be issued by the securities companies and other financial institutions in accordance with law. While Jiangsu High Court recognises the enforceability of a subordination arrangement in a precedent case, contractual subordination arrangements among unsecured creditors have a lack of legal basis under the Bankruptcy Law; therefore, it is uncommon to see this in practice.

V JURISDICTION

i Governing law

In a domestic transaction, Chinese law should be the governing law of the transaction agreement. In cross-border transactions, the parties may choose the governing law of the transaction agreements. English law, Hong Kong law and New York law are most often chosen by the parties as the governing law of the cross-border credit facility agreement.

In the absence of a choice of law, the court will apply the rules of closest connection to determine the governing law. For example, the law of the jurisdiction in which the lender is located may govern the financing agreement.

There are some exceptions to the parties’ freedom of choice of law. Where the collateral is the immovable asset, the law of the jurisdiction where the immovable assets are located should be the governing law of the security agreement. Chinese law mandatorily applies to certain agreements relating to foreign investment in China, such as, for example, share purchase agreements, assets purchase agreements and subscription agreements involving foreign entities, as well as Sino-foreign equity joint venture contracts, Sino-foreign contractual joint venture contracts and contracts for Sino-foreign joint exploration and development of natural resources that will be performed within China.

Generally, the courts will uphold the choice of law provisions as long as such provisions do not violate public policy of China or contradict the mandatory provisions of Chinese law.

If the court determines that the parties intentionally create the ground to apply foreign law in order to avoid the application of Chinese law, it will not uphold the application of foreign law and Chinese law will apply instead.

ii Recognition of foreign judgment or arbitration award


Where a final and conclusive civil judgment or written order of a foreign court or an arbitral award of a foreign arbitral tribunal is submitted to a Chinese court for recognition and enforcement, it will be reviewed by the court in accordance with the treaty concluded between China and the jurisdiction where the judgment, order or award is made or in accordance with the principle of reciprocity. If the court determines recognition and enforcement does not violate basic principles of Chinese law or is not contrary to the sovereignty, national security
or public policy of China, it will recognise the foreign judgment, order or award. In the absence of the treaty or reciprocal relationship, the court will render a ruling to dismiss the application, unless the party concerned applies to the people’s court for recognising a legally binding divorce judgment rendered by the foreign court.

**VI ACQUISITIONS OF PUBLIC COMPANIES**

The Measures on the Administration of Acquisition of Listed Companies (the Acquisition Measures) promulgated by the China Securities Regulatory Commission (CSRC) are the major regulations on the acquisition of public companies. Acquisition of listed companies can be taken through agreement or tender offer.

**i Mandatory offer requirement**

If the shareholding percentage of a purchaser in a listed company does not exceed 30 per cent, and the purchaser wishes to further increase its shareholding percentage therein, it should launch the general or partial tender offer, provided that the shares proposed to be acquired should not be less than 5 per cent of the issued shares of that listed company. If a purchaser holding more than 30 per cent of the issued shares of a listed company wishes to further increase its shareholding percentage, it should launch the general tender offer to acquire all the shares of the target company. The purchaser may apply to the CSRC to waive the foregoing tender offer or general tender offer requirement.

**ii Disclosure of the financing terms**

The tender offer report should, among other things, disclose the financing arrangement. However, detailed terms, including the flex and fees, are not required to be disclosed.

**iii Squeeze-out**

There are no squeeze-out rules in China. However, in the case of a general tender offer, the purchaser is required to specify in the offer report, among other things, the closing date after delisting and arrangements for the shares held by the remaining shareholders after expiration of the offer period. If, at the end of the offer period, the target company fails to meet the listing requirement (i.e., less than 25 per cent of the shares are held by the public, or the total value of the shares of the target exceeding 400 million yuan, less than 10 per cent of shares are held by the public), the target company should be delisted. If requested by the remaining shareholders, the purchaser should purchase the shares then held by the remaining shareholders within the timeline as provided in the purchaser’s offer report on the same terms as the tender offer.

**iv Conditionality**

In the case of a tender offer, the purchaser should first prepare the offer report and disclose the summary of the offer report in a brief announcement. All the conditions to the offer should be highlighted in the summary of the report. The offer report will be disclosed after the conditions have been satisfied. Unless otherwise waived by the CSRC, the offer report is unconditional. Chinese law currently does not stipulate the requirement of the conditionality to the offer. Obtainment of the governmental approval is commonly seen as a condition in the summary of the offer. There are cases where satisfaction to the due diligence result by the purchaser is the condition in the summary of the offer.
v  Form of payment
The purchaser may, by means of cash, securities, or combination of cash and securities, or by other lawful means, pay the purchase price for acquisition of a listed company. In the case of payment in securities, the purchaser should provide audited financial and accounting statements, and a securities evaluation report of the issuer of the said securities for the past three years, and should cooperate with the independent financial adviser engaged by the target company in its due diligence investigations. In the case of payment in transferable bonds, the bonds must have been listed in the securities exchange for at least one month. In the case of payment in securities that are not listed in any securities exchange, the purchaser must meanwhile provide the cash payment option for the offerees to choose.

In the case of a general tender offer to acquire all the shares of the target company, the consideration should be paid in cash. If the purchaser wishes to pay the consideration by transferable securities, it must, at the same time, offer the cash payment option for the offerees to choose.

vi  Certain funds requirement
The purchaser should provide at least one of the following measures to guarantee the performance:

a  in the case of payment of the purchase price in cash, a deposit of not less than 20 per cent of the total consideration to the designated account of securities depository and clearing institution; in the case of payment of purchase price in securities, a deposit equaling the value of all the securities used for payment in the custody of the securities depository and clearing institutions;

b  a bank guarantee covering the total purchase price; and

c  a written commitment issued by the financial adviser undertaking joint and several liability for payment of consideration.

The financial adviser of the purchaser is also required to conduct due diligence on the purchaser’s capability and source of funds, and to specify whether the purchaser has the ability to complete the tender offer in its report and whether there is any circumstance where the purchaser obtains the financing by way of mortgaging the target shares.

VII  THE YEAR IN REVIEW
Owing to the trade frictions between China and the United States and the enhanced scrutiny on Chinese investment in US firms by the Committee on Foreign Investment in the United States, Chinese investment in the United States has dropped since 2018, from a peak of US$46.5 billion in 2016 to just US$5.4 billion in 2018.2 While China’s global outbound investment surged in 2018 and was broadly flat in the first half of 2019, it was led by technology, media and telecommunication (TMT), life sciences and mining and metals. TMT remains the most attractive sector to Chinese investors by number of deals.

On the other hand, foreign direct investment into China rose 3.6 per cent year-on-year to US$78.8 billion in January to July 2019, or 7.3 per cent to ¥533.14 billion. This was driven by the continuing opening-up of Chinese market. A new Foreign Investment Law (the New FDI Law) was promulgated on 15 March 2019 and will come into effect on 1 January 2020, replacing the existing three laws on foreign investment (i.e., the Law on Sino-Foreign Equity Joint Ventures, the Law on Sino-Foreign Contractual Joint Ventures and the Law on Wholly Foreign Owned Enterprises – collectively, the Existing FDI Laws). The New FDI Law is considered as an effort of the Chinese authorities to address foreign concern and criticism on Chinese openness, by, for example, pledging to grant equal treatment to foreign investors as that to their domestic counterparts, access to public procurement, prohibiting infringement of intellectual property rights and trade secrets, and barring Chinese authorities from forcing technology transfer. Furthermore, the New FDI Law will ease restrictions on those industries that were not accessible to foreigners.

The 2019 editions of the Negative List and Encouraged List for foreign investment, jointly promulgated by the National Development and Reform Commission and the Ministry of Commerce on 31 June 2019, are important supplements to the New FDI Laws. In contrast to the 2018 versions, there are fewer sectors where foreign investment is restricted (e.g., allowing foreign investors to have controlling interest in exploration and development of certain types of oil and natural gas, construction and operation of cinemas, domestic shipping agents), and more sectors have been added to the encouraged sectors for foreign investment. Foreign investment in encouraged sectors will be eligible for preferential treatment (e.g., tax, land prices). Foreign-funded projects in sectors not falling under both lists will enjoy national treatment.

Furthermore, according to a guideline jointly released by the National Development and Reform Commission, the People’s Bank of China, the Ministry of Finance and the China Banking and Insurance Regulatory Commission, the Chinese government will step up efforts to support financial institutions to conduct market-oriented debt-for-equity swaps on qualified enterprises, with the aim of reducing high corporate leverage to resolve debt risks for private business, and to boost the growth of private economy.

VIII OUTLOOK

To respond to the New FDI Law, it is expected that the Chinese government will introduce a series of implementing regulations and directives to protect the rights and interests of foreign investors in the foreseeable future. Foreign investment in China will continue to be boosted, driven by the relaxation of market access.

However, the long-term trend of Chinese companies investing overseas will continue, especially in the sectors of infrastructure, agriculture, energy and resources, high-tech and services that are in line with the Belt and Road Initiative.

Various measures will also be unveiled to lower enterprise leverage and handle the debt issues of ‘zombie companies’ and to optimise the safeguard mechanism for bankruptcy; for example, the government will encourage commercial banks to set up financial asset investment subsidiaries to accelerate debt-for-equity swaps, and will allow financial institutions to raise capital by selling asset management products to invest in debt-for-equity programmes. Private capital will also be encouraged to participate.

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I OVERVIEW

The use of acquisition finance provided by a bank or bank syndicates in order to finance M&A deals is the most common form of finance in the Danish market. Before the financial crisis, around 80 per cent of the purchase price in most deals was leveraged, or ‘geared’, and while this has now fallen back, leveraged finance remains key to the investment cycle.

While leveraged finance in Denmark continues to be dominated by ‘senior loans’ from large investment banks, the growth of alternative debt providers representing smaller banks providing mezzanine loans in return for equity (junior loans) represents a diversification in the source of acquisition finance. In addition, the state-backed Danish finance institute Vækstfonden – which has recently seen its mandate increased significantly – plays a huge role in providing finance to small and medium-sized enterprise market deals, especially within emerging technologies and internationalisation.

In order to promote innovation and entrepreneurship, the Danish government decided to introduce the ‘entrepreneur company’ (IVS) in 2013, with a capital requirement of only 1 krone. However, since these companies were criticised in public for being creditor shelters, especially in relation to VAT and company tax payments, the Danish government abolished these entrepreneur companies. All existing IVS companies shall be transformed into private limited (ApS) companies before 15 April 2021, otherwise the company will be dissolved by the Danish courts. In order to compensate for this and to strengthen innovation, capital requirements for stock-based corporations (A/Ss) and ApSs were lowered to 400,000 kroner and 40,000 kroner respectively.

II REGULATORY AND TAX MATTERS

i Regulatory matters

Banking and financing services provided in Denmark are primarily regulated by the Financial Business Act, which dates back to 2004 combining regulation for all financial institutions. Danish-domiciled banks must be licensed by the Financial Supervisory Authority (FSA). Other EU and EEA regulated banks may also conduct business in Denmark through the
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cross-border freedom of services rules (passporting) or through a branch office registered in Denmark. The formalities follow the principles stated in the EU Credit Institution Directive, Articles 25 and 28. Non-EU banks must register a company or a branch office subject to a licence from the Danish FSA. A formal licence in one of these three ways is required only, however, if the bank conducts business in Denmark and does not prevent any foreign-licensed bank from granting loans or credits or participating in any other way in the financing of a Danish transaction and receiving security from Danish assets when being passively approached by either the target company or the investor.

Securities that are offered to the public or a wider circle of purchasers must be offered on the basis of a prospectus prepared in accordance with the EU Market Abuse Regulation, previously regulated by the Securities Trading Act. The Market Abuse Regulation excludes offerings to professional investors and to a narrow circle of prospective investors (less than 150) and larger individual investments (greater than €100,000 per unit or a sum taken by a single investor). Securities include, inter alia, equity shares and bonds. The listing requirements from the Market Abuse Regulation are detailed in the NASDAQ rules for issuers of shares and the rules for issuers of bonds. NASDAQ also operates the First North trading platform. However, First North has not been considered a success and few new companies have been floated on First North in recent years. At present, there is no effective over-the-counter platform in Denmark. In 2018 the Swedish stock exchange named ‘AktieTorget’ announced that it has decided to enter the Danish IPO market for small and midsize companies under the name ‘Spotlight’ since more than 20 Danish companies had chosen to be listed on AktieTorget in Sweden, and for that reason must first reincorporate into a Swedish corporation, increasing administrative costs and bureaucracy. Currently, there are 12 Danish companies listed on Spotlight with an aggregate market cap of approximately 0.5 billion kroner.

Growing focus on anti-money laundering has resulted in amendments to previous legislation that also add to the requirements for financial institutions to scrutinise clients and transactions. Examples include the Anti-Money Laundering Act No. 651 of 8 June 2017 and the amendment to the Companies Act No. 262 of 16 March 2016, Section 58a introducing a requirement to identify real owners of corporations, etc., with a stake exceeding 25 per cent (or less where control may still be exercised, e.g., through board representation or veto rights) and register their names in a publicly available register from 1 December 2017. To this end, the physical persons behind offshore structures must now be registered in the Danish public register. We have yet to see the effect this might have on foreign investments into Denmark.

In 2017 and continuing in 2018 and 2019 the issue of money laundering hit the public agenda due to a large financial scandal involving the largest Danish banks, primarily Danske Bank which is accused of large-scale money laundering in its Estonian branch, but also Nordea Bank. The scandal also hit the front pages of the international financial news, since the branch had thousands of suspicious customers responsible for over €200 billion of transactions over nine years. As a result, the CEO resigned, and a large police investigation has been launched. As a consequence, the Danish money laundering legislation as well as the oversight by the Danish FSA have been significantly strengthened. Denmark transposes

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5 EU Market Abuse Regulation 2014/596. See also Act on Capital Markets No. 650 of 8 June 2017 and amendment to Financial Business Act No. 665 of 8 June 2017.
7 Companies Act, consolidated Act No. 1089 of 14 September 2015.
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the 5th. AMLD, and the rules will be enacted 10 January 2020, which is supplemented by Danish national rules that were enacted on 1 July 2019 (mainly on increased protection of whistle-blowers).

The increased ‘know your client’ requirements for financial institutions when onboarding new customers often also proves a very cumbersome, time-consuming and costly process.

Also, the CRR Regulation\(^8\) and CDR IV Directive\(^9\) and various recent implementations from the MIFID Directive into Danish legislation have added to the regulatory requirements for financial institutions. This, in turn, continues to be a challenge for smaller banks where the cost of compliance requirements is relatively high and reduces the number of genuine local competitors in leveraged financing, and opens up the possibility for foreign bank financing of large transactions and alternative (non-regulated) financing for smaller transactions. Certain midsized banks, even those ranking at the bottom of the top 10 list, will often refuse to onboard foreign customers.

Denmark transposed the revised Shareholder Directive (2017/828/EC amending Directive 2007/36/EC) in the spring of 2019 and the Danish rules are in force from 10 June 2019. In brief, these rules require the approval by the general meeting in listed companies of the remuneration policy and disclosure of a remuneration report. Listed companies have a right to know their ultimate owners (this information shall be supplied by deposit banks and shareholder register services). In addition, transactions between related parties shall be disclosed when the board of directors approve the transaction.

\[\text{ii Tax}\]

**General remarks**

Leveraged financing must consider both tax rules for debt financing costs, dividends, interest payment and withholding tax; and exit tax on profit from the investment. Also, the rules available for tax consolidation and intercompany transfer pricing must be considered. Transfer pricing rules in particular may offer special challenges, as their interpretation depends on the nature of the individual transactions and requires detailed analysis of the specific case.

Dividend distributions from a Danish company are generally subject to a 27 per cent withholding tax; see below.

Capital gains from the sale of shares in a Danish company owned by a foreign corporate investor are generally not taxable in Denmark, but only in the country where the investor has its tax domicile.

Where the transaction also includes a loan to the target company, whether offered by the investor or by a third-party local or foreign financing partner, the interest payable on the debt can be deducted for tax purposes by the Danish target company and is taxable only in the country where the creditor is tax-domiciled. There is no withholding tax on interest payments from Denmark. Where the investor is also the lender, transfer pricing issues must be considered to ensure that the interest rate corresponds to the market rate. There are special rules for debt in certain thinly capitalised companies and passive foreign investment companies.

\(^8\) Regulation 575/2013/575 of 26 June 2013 on prudential requirements for credit institutions and investment firms.

\(^9\) Directive 2013/36/ of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.
**Danish corporation tax**

Danish corporation tax is 22 per cent (2019) of the calculated net income from all sources except dividends received from shareholdings exceeding 10 per cent in other corporations. The taxable income is calculated after depreciation on certain assets.

Losses from previous years can be deducted without time limitation (since 2002). Tax losses are lost, however, in the case of tax-free mergers and where more than 50 per cent of the ownership at the beginning of the tax year has changed at the end of the tax year, either through transfer of shares or contribution from new shareholders.

Group contributions from a parent company to a subsidiary company are considered taxable income to the receiving company and not necessarily deductible by the contributing company. A tax-free contribution may be effected, however, between group companies subject to group taxation. Funds injected through a capital increase, including any premium on the nominal increase, is tax free. A subsidiary may also offer loans to finance the purchase of shares in the company, provided the amount offered could be distributed as dividends, and the financing has been pre-approved by the general meeting of shareholders and published through the Danish Business Authority (see the Companies Act Section 206).\(^\text{10}\)

**Tax consolidation**

Danish group companies, in other words, the parent company and its subsidiaries defined as companies owned or controlled by the parent company, are forced to participate in a joint taxation scheme.

Joint taxation with foreign group companies is also possible, provided that all foreign group companies are included in the joint taxation. The choice is binding for a period of 10 years and can be prolonged for another 10-year period.

**Withholding tax**

There are no withholding taxes on interest payments.

Dividend distribution from a Danish company is subject to a 27 per cent withholding tax (see below). However, many double taxation treaties reduce the effective tax to 15 per cent or even lower, and allow the shareholder to apply for a refund of the excess amount. If the shareholder has its registered office in the EU and is the holder of more than 10 per cent of the shares in a Danish company, according to the EU Parent–Company and Subsidiaries Directive,\(^\text{11}\) the dividend distribution is tax exempt and the entire withholding tax can be refunded. If the companies are registered as tax group companies, there is no withholding tax.

In recent years, these rules have been abused in a number of countries, including Denmark, where tax refunds have been wrongfully claimed. In Denmark, this has caused a significant loss for the Danish tax authorities, for an amount of close to €2 billion. For that reason, the administration of the rules has been tightened. There has also been political criticism of the opportunity for non-EU investors to organise investments though an EU vehicle created for the purpose, thereby benefiting from the favourable EU rules, although the profit is ultimately passed on to an investment holding company in a tax haven jurisdiction. So far it is recognised, however, that these constructions do not violate current legislation and must be accepted.

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10 Companies Act, consolidated Act No. 1089 of 14 September 2015.
11 Directive 2011/96 on taxation applicable for parent companies and subsidiaries of different Member States.
### Deductibility of interest

The Danish Companies Tax Act, 12 Section 11 allows the tax authorities to limit tax deduction where the debt/equity ratio exceeds 4:1. In this case, interest expenses for the part of group debt exceeding the 4:1 ratio limit can be excluded from interest payments.

Through the EU Directive on tax avoidance practices, 13 from 1 January 2019 Member States must apply the measures stated in the Directive to prevent companies from exploiting national mismatches to avoid taxation. The rules will limit the interest deduction to 30 per cent of EBITDA or €3 million.

### III SECURITY AND GUARANTEES

In any leveraged finance transaction, there are two different financing aspects to consider: financing the acquirer's investment in the equity of the target company and financing for continuing business of the target company, especially where the previous shareholders have been backing the operating capital of the target company and wish to be released from guarantees or satisfied for outstanding loans.

Special issues arise when these elements are connected, because the acquirer wishes to use the assets of the target company as collateral for the financing of the equity or the creditors of the target company wish to secure the support from the acquirer, especially where the acquirer becomes a majority shareholder. In Danish law, downstream support is allowed whereas upstream support is possible only to a limited extent.

#### i Security packages

Acquisition financing can be secured through the pledge of assets belonging to the acquirer. As the shares in the target company do not belong to the acquirer before they have been purchased, there must be an element of open credit if these shares are intended to be the only assets securing the financing. As described in Section III.ii, there are some possibilities, however, for a target company to secure the purchase of shares in the target company.

On the other hand, the shares in the acquiring company may serve as security for the financing of the acquisition of the shares in the target company. These shares are owned by the shareholders in the acquiring company, and they must agree to pledge the shares if that is required from the financing company. Such pledge may be offered for an interim period only until the target company shares become available for pledging.

Alternatively, the shareholders of the acquiring company may be asked to offer a guarantee or surety for the debt owed by the acquiring company. The debt may be structured as corporate bonds issued by the acquiring company, either as stand-alone debt or secured by the shareholders or other third parties. However, corporate bonds are rarely used except in very large transactions due to the cost of creating and selling the bonds.

Pledges of shares may be supported by surety; this is probably the most common security for financing the acquisition price.

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13 Directive 2017/1164 of 12 July 2016 on rules against tax avoidance practices that directly affect the functioning of the internal market.
The pledge is provided through a simple agreement and perfection by notification of the pledge to the issuing company, and a notation thereof in the company shareholder register. For shares representing more than 5 per cent of the total share capital, notification to the official register of owners kept by the Danish Business Authority is also required. There is no stamp duty. In the unlikely event that the shares are negotiable instruments, the share certificate representing the shareholding must also be endorsed and handed over to the beneficiary for the pledge.

A supporting surety is also executed as a simple undertaking by the guarantor delivered to the creditor who benefits from the surety.

Financing the future operating capital of the target company is more commonly secured by intragroup loans. The loan is defined in a promissory note signed by the debtor and delivered to the creditor. There is, therefore, no stamp duty incurred there either. No perfection or other registration is required.

For that reason, both pledge of shares and intragroup loans can be easily provided and arranged to come into force immediately after execution and be available upon closing.

Other types of security may also be considered, especially to provide working capital, and perhaps repay interim group financing. The list below is not exhaustive:

- a real property mortgage offers priority in the named real property for the amount mentioned in the mortgage certificate that is created electronically in the Land Register part of the Registration Court. There is a charge of 1,660 kroner plus 1.5 per cent of the secured amount;
- movable property may be mortgaged in the same way as explained for real estate, but in a special section of the Registration Court identifying secured obligations for each physical person and legal entity, where applicable; there is a special register for automobiles. There is a charge of 1,660 kroner plus 1.5 per cent of the secured amount;
- a floating charge in business assets may also be created by registration under the company's registration number, stating the amount secured and the creditor. Unlike a mortgage of specific movable property, business assets, such as stock, fixtures and receivables are mortgaged to the extent that they are part of the business assets;
- bank account deposits may be pledged as other receivables. In this case, the bank is the debtor and the pledge is perfected by notifying the bank of the pledge. When the bank has been notified of the pledge, it cannot release funds to the account-holder without acceptance from the mortgagee;
- invoices, trade receivables and contractual rights may be pledged to the effect that the debtor is released from his or her obligations only when the debt is paid to the mortgagee, provided the pledge is perfected through notification to the debtor;
- insurance contracts may be pledged, and that is often the case as a supplement to a pledge in the asset that is insured such as real estate, automobiles and stock. The pledge is perfected by notification to the insurance company;
- intellectual property rights, such as patents and trademarks, can be pledged and the pledge perfected by registration in the relevant public registers;
- ships, aircrafts and automobiles have their own public registers where a pledge must be registered to secure perfection;
- reservation of title in movable goods supports the right to collect the receivable. Reservation of title does not require perfection except in case of reservation of title to automobiles. Reservation of title is lost when goods intended for resale are in fact sold to the next purchaser; and
Although an asset has been pledged, it is possible to create a second-ranking security over the same asset to benefit from possible excess value in the asset over and above the priority pledge. A similar situation can be created for debt instruments with or without security. Where a debt is labelled as mezzanine to an identified senior lender, there is an intercreditor agreement whereby the mezzanine lender accepts not to be paid before the senior lender has been fully satisfied for his or her loan. This arrangement is often administered by a security or financing agent who is paid by the debtor; funds are distributed in order of priority.

### ii Limitations on security and guarantees

#### General loan prohibition

The Danish Companies Act, generally prohibits a company from providing loans to or security in favour of its direct shareholders and other upstream shareholders, management and board members. As an exception Section 211 allows a company to offer loans to its Danish parent company and to certain non-Danish companies as identified by the Danish Business Authority.  

It is also allowed to make ordinary business transactions between a company and the circle of persons mentioned in Section 210, even though such transaction results in an element of credit and thereby effectively a loan.

#### Financial assistance prohibition – self-finance

A Danish limited liability company may not grant loans, security or guarantees, or both, to assist the financing of the purchase of shares in the same company or its direct or indirect parent company.  

However, since 2008, the Companies Act, Section 206, has in certain circumstances allowed a company to offer loans or guarantees to finance the purchase of shares in the company, provided the amount offered could be distributed as dividends and the financing has been pre-approved by the general meeting of shareholders and published through the Danish Business Authority (self-financing). If the acquiring company is able to raise interim financing for the purchase of the shares based on an expectation that a subsequent distribution of dividends will allow the bidder to repay the loan, there is no need for the use of Section 206. On the other hand, Section 206 allows the company to fund the purchaser with the full amount available for distribution despite the fact that the bidder is not purchasing or subscribing for 100 per cent of the shares and therefore would not receive 100 per cent of the dividends when distributed. That is the reason why the support must be accepted by the (other) shareholders in a general meeting of shareholders.

14 Companies Act, consolidated Act No. 1089 of 14 September 2015.
15 See Government Order No. 275 of 25 March 2010. As a general principle parent companies in OECD group 0 and 1 countries are qualified to receive loans and guarantees from Danish subsidiaries. These countries include Western European countries, Australia, Canada, Hong Kong, Japan, Singapore and the United States of America.
Dividends

A Danish company may distribute profits to its shareholders, provided the amount can be taken from accumulated profits excluding undistributed profits from subsidiaries, and provided further that in the opinion of the board of directors the company is left with sufficient operating capital after the dividend distribution. An ordinary distribution of dividends is decided by the annual general meeting of shareholders when the annual report is presented to and accepted by the shareholders; however, the general meeting cannot decide to distribute an amount above what has been suggested by the board of directors.

According to Section 182 et seq., it is also possible to distribute dividends outside the annual general meeting, and the general meeting may authorise the board of directors to distribute extraordinary dividends. The amount available is the same as the amount stated above, however, with due consideration to the operating result during the interim period from the end date of the last annual accounts. In public limited companies, an interim balance sheet must be prepared if more than six months have passed since the end date of the last annual accounts, which is almost always the case since most annual general meetings are held more than four months after that date.

Corporate benefit

Despite the fact that a company is controlled by another company – or even owned 100 per cent by that shareholder – each company must be treated as a separate entity and first and foremost consider its own interest. For that reason, a subsidiary company may not engage in any transactions with other group companies where the transaction operates against the interest of the subsidiary company, as the shareholder may not exercise its controlling interest to its own advantage where there is a conflict of interest. If it does so nevertheless, not only the company, by also the persons who have participated in the decision, may be held liable to pay compensation.

iii Transactions immediately prior to insolvency proceedings

A company can be placed in bankruptcy when it is facing insolvency (i.e., when it cannot pay its debts as they fall due, and the situation is not of a temporary nature). Either the company itself, represented by the board of directors, or a creditor may submit a petition for bankruptcy. Even though a company is not considered to be insolvent, it may be decided to close it through a solvent liquidation, or the Danish Business Authority may decide to ask the probate court to close the company if it has not filed its annual accounts within the time prescribed (five months after the end of the fiscal year). If during that process the company is found to be insolvent, the process changes into bankruptcy proceedings.

According to Section 119 of the Companies Act, the management of the company must ensure that a general meeting of shareholders is held within six months after the management becomes aware of the fact that more than 50 per cent of the registered share capital has been lost with the purpose of proposing to the shareholders how to address the situation. It is not a requirement to close the company or even to file for bankruptcy if management can secure financing until the equity capital has been restored, for example, through a parent company loan. Alternatively, it may be decided to increase the share capital or to structure a loan as subordinated to other debt. For this reason it is normally advisable to keep the nominal share capital in a Danish company as low as allowed by law and to pay additional capital as share premium.
If the company is placed in bankruptcy, there are certain regulations in the Danish Bankruptcy Act\(^{16}\) that allow the receiver to seek to claw back payments made to closely connected parties such as a parent company or security offered for existing loans shortly before the bankruptcy. Fresh loans can be granted against security offered by the debtor and will be respected if the security is perfected simultaneously when or before the loan is paid out.

The general clawback period is three months, but particularly with regard to closely connected parties the period can be as long as two years or even without limitation if the company was insolvent when the transaction was made and the participating party was aware of that fact or ought to have been aware of it. The period is calculated from the time when perfection was effected where perfection is required. Without required perfection, the transaction can simply be set aside by the bankruptcy estate.

**IV PRIORITY OF CLAIMS**

### i Legal order of priority

In a bankruptcy scenario, the priority of claims is set out in the Danish Bankruptcy Act, Sections 93–98.

Although the general principle of Danish bankruptcy law is equality of the creditors, dividends of a bankruptcy estate are paid according to different classes of claims, each pertaining to a varying level of priority. Only when all claims enjoying a higher priority within one class of claims have been fully satisfied will the next class of claims receive dividends. If, in the event of bankruptcy, remaining assets of the estate are insufficient to satisfy all outstanding claims of any class, the claims will receive dividends pro rata (e.g., all claims are covered by up to 20 per cent).

There are six classes of claims, and they are prioritised as follows:

- **a** primary mass claims: costs related to the bankruptcy notice, administrator's fees and costs accrued by the administrator on behalf of the estate;
- **b** secondary mass claims: costs accrued by the creditors' attempt to reach a composition or other similar arrangement to resolve the debt issue and other specific costs;
- **c** wage-earner's privilege: all types of claims from wage-earners against the company, particularly wage claims;
- **d** supplier's privilege: suppliers may claim tax and duties paid for dutiable goods before delivery to the bankrupt company;
- **e** simple claims: any other claims except for the subordinated claims; and
- **f** subordinated claims:
  - first priority: interest of claims after delivery of the bankruptcy notice, except for interest of primary or secondary mass claims;
  - second priority: fines and other penal instruments and liquidated damages beyond the actual loss; and
  - third priority: claims for presents.

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\(^{16}\) Bankruptcy Act, consolidated Act No. 11 of 6 January 2014, Section 64 et seq.
It is important to note that claims that are secured by way of a charge over certain assets, guarantees, etc., are first settled with the proceeds from such secured assets, etc. (i.e., outside the ordinary order of claims). Any unpaid balance can be filed as a claim in the normal priority of claims. Secured assets fall outside those assets of the estate that are used to satisfy unsecured claims.

ii  Intercreditor agreements and subordinated loans

Intercreditor agreements (i.e., agreements between multiple creditors regulating the priority of claims and other aspects between the creditors) are legal and enforceable in Denmark. However, such agreements are only binding upon the creditors, and not the administrator of a bankruptcy estate. The administrator will pay dividends according to the formal priority of the claim, and will not consider any intercreditor agreements. The creditor with priority under such agreement will have to collect the dividend from the other creditors.

A subordinated loan is classified as a simple claim, but takes the last priority. The administrator will only pay dividends to the subordinated loan once all other simple creditors are paid fully, but before any of the subordinated claims (see above) receive dividend.

iii  Pledged assets

As a general rule, the administrator is under an obligation to respect a pledge even if the claim is classified as subordinated in the legal priority. A pledgee may try to satisfy his or her whole claim through a forced sale of the pledged asset, including interest, but only insofar as the pledged asset does not cover the whole claim, the pledgee shall file the claim with the administrator under the same priority rules as for any other creditor. Pledges may be reversed as stated above.

V  JURISDICTION

i  Venue

In the European context, Danish courts are bound by the Brussels I Regulation recast and adopted as of 2012. This regulation effectively leaves it to the parties to agree to a venue, provided the agreement follows the forms of the regulation. In the absence of a venue clause, a party shall be sued in the court of that party's Member State. The general rule is widely derogated from, not only because most commercial contracts include a venue clause, but also because the regulation contains several special rules on venue including that of exclusive jurisdiction.

The system of the Brussels I Regulation is widely repeated in the national legislation that applies between third parties and Danish parties. The parties may choose a venue, and in the absence of such clause, a party shall be sued in his or her own state, unless one of the special venue rules apply.

Denmark stood apart from the rest of Continental Europe in not subscribing to uniform European legislation on the jurisdiction, recognition and enforcement of judgments in civil and commercial matters as represented by the Brussels I Regulation from the outset. However, following an agreement in 2005 and despite its continuing opt-out from European legislation in justice-related matters, a judgment obtained from the courts of any EU Member State or in Norway, Switzerland or Iceland will be recognised and enforced if it is referred to in the Danish courts.
Many finance contracts use Copenhagen arbitration as the agreed venue. The Maritime and Commercial Court has a system of commercial judges and is an often-used venue for commercial disputes. When finance is provided by foreign financial institutions, a venue outside Denmark will frequently be chosen, often based on foreign law (often English law) being chosen.

ii Choice of law

In general, Danish courts, like their Scandinavian counterparts, are likely to recognise and give effect to a foreign choice of law clause. In the absence of a valid choice of law by the parties, Denmark has consistently implemented the 1980 Rome Convention on the Law Applicable to Contractual Obligations, the forerunner to the Rome I and Rome II Regulations. In this light, Danish courts will provide that in such an absence, the contract shall be governed by the law with which it is most ‘closely connected’. In this respect, Danish courts uphold a rule that is flexible enough to confer significant judicial discretion to determine the applicable law. Indeed, this is a unique position in comparison to other European jurisdictions, hamstrung by the subsequently agreed Rome I and II Regulations, which enforces a presumption that the only relevant connection is where the performer of the contract is domiciled.

iii Arbitration

Denmark recognises the parties’ rights to choose arbitration as the competent forum. The parties may decide the number of arbitrators, and in absence of such choice, the number of arbitrators will be three. Denmark has ratified the UN Convention on the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958. Under this Convention, a foreign arbitrational award will be enforced in Denmark without any previous trial before the courts.

VI ACQUISITIONS OF PUBLIC COMPANIES

In Denmark, in the event of the acquisition of a publicly listed (on the stock exchange or on other regulated markets in Denmark) company, the takeover rules of the EU Market Abuse Regulation 2014/596, the new Danish Capital Market Act (Lovbekendtgørelse No. 12 of 08/01/2018) Chapter 3, the Executive Order on Takeovers17 and the Danish Companies Act apply. Together, they provide procedural guidelines for each part of the takeover process. In Denmark, the acquisition of public companies is usually effected with the intention of the buyer to delist the entity to precipitate managerial and directional change. In order to achieve this, a buyer and those acting in concert with him or her will seek to achieve full control of the company, namely, 90 per cent of share capital. However, it is common for many Danish listed companies to issue a number of classes of shares, for example, A and B, with varying degrees of preferential rights to prevent a hostile takeover achieving this outright. Such provisions are found in the ownership structure of many large Danish companies, Carlsberg to mention one. Often a foundation controls the company by having the shares with superior voting rights (A shares) whereas the normal shares (B shares) are listed and often held by large institutional investors. In this regard, the legislation provides the means for a gradual, if inevitable and eventual, takeover should circumstances provide.

17 Executive Order on Takeover Offers, No. 562 of 2 June 2014.
Sometimes, families hold the A shares, and in such a case, it is possible to acquire control with a listed company by having the support of the A-shareholders before launching a tender offer to the B-shareholders.

A recent academic article published in the Nordic Company Journal documents that the takeover premium in Denmark equals 30 per cent. Moreover, the authors show that the premium does not depend on whether target shareholders are compensated with shares in the bidder company or, alternatively, with cash. On the other hand, the takeover premium is significantly higher for voluntary tender offers than mandatory offers as well as when the offer is recommended by the board of directors in the target company.

In many cases, as part of a friendly takeover, an acquirer will seek to open negotiations with individual shareholders and purchase shares gradually, the disclosure of which will be necessary for every piercing of thresholds of 5 per cent of the share capital (i.e., 5, 10, 15, 20, 25, 30 and so on). However, should the shareholder subsequently acquire a controlling influence over the company (i.e., one-third of the voting rights through the direct or indirect transfer of shares), one is mandated to offer to purchase all outstanding shares on identical terms – the mandatory bid. A controlling influence can also be elicited whereby the shareholder exercises a majority of the voting rights according to an agreement with the shareholders or articles of association, and also has the ability to determine the financial and operational affairs of the company. However, such a bid can be avoided in the event the acquirer submits a voluntary bid to all shareholders provided they obtain more than 50 per cent of the voting rights. As regards the latter, the offeror is entitled to make his or her offer conditional on acquiring competition clearance, or a specified level of acceptance so as to confer controlling influence (as above) or 90 per cent of share capital and voting rights to result in a legal squeeze out.

However, in either case, a prospective acquirer must submit an offer document that must include details indicating how the offer may be financed, the terms of the offer and the price. For instance, there must be a deadline permitting enough time for shareholders to make a well-informed assessment of the offer and the future plans for the company, in other words, if a prospect to distribute profits will be refused within the first 12 months. All matters within the offer documentation, including potential details of the syndication of loans, will be subject to confidentiality agreements as, combined, the details represent insider information.

Assuming the buyer wishes to delist the entity, the acquirer would need to secure more than 90 per cent of the share capital and voting rights to precipitate a minority squeeze out or the compulsory redemption of outstanding shares, as given in Section 107 of the Companies Act. This would confer the necessary control to engineer permanent organisational change and request a delisting from the Copenhagen Stock Exchange, but that is by no means automatic. Provided there is no significant harm to minority shareholders while taking into account the number of minority shareholders and value of the shares, a delisting will normally occur. However, famously, the takeover of TDC, a Danish telecommunications company, was thwarted by ATP, the Danish pension fund, which refused to have its remaining 10 per cent of shares redeemed. The circumstances under which a minority squeeze out can occur remain contentious, and will likely be subject to further review.

19 Capital Markets Act, Section 44-45.
20 Capital Markets Act, Section 78.
VII THE YEAR IN REVIEW

Generally, anti-money laundering procedures, especially in banks, are high on the agenda. Also illegal shareholder lending from corporate companies receives high levels of attention and attracts frequent fines also when the loan is repaid.

New rules for listed companies on remuneration policy and remuneration reporting was enacted on 10 June 2019 as a result of the Danish transposition of the revised Shareholders Directive (EU/2017/828). The law contains four new main topics: (1) listed companies will now be better able to identify shareholders; (2) listed companies must prepare and publish a policy for remuneration of directors, which sets the framework for fixed and variable remuneration of the management members, as well as presenting and publishing a remuneration report; (3) in listed companies, significant transactions between the company and its related parties must be approved by the board of directors before the transaction is completed, and the company must publish a notice of certain significant related party transactions; and (4) institutional investors and asset managers must, among other things, publish an active ownership policy or explain why they will not publish one.

Danish IVS companies are phased out, and the capital requirements for ApSs is reduced to 40,000 kroner.

In 2018–2019 two major disputes hit the Danish newspaper headlines. In June and August 2018, the FSA conducted an inspection of the Københavns Andelskasse, a small banking institution. The FSA found that the bank violated the regulation in all areas investigated, including and specifically concerning anti-money laundering. This was a repetition of findings in previous inspections. In addition, the FSA stated that Københavns Andelskasse had not properly calculated its capital base, solvency need or liquidity. Since this was a breach of fundamental requirements, the bank was closed and its winding up passed to the government institution Finansiel Stabilitet.

On 26 June 2019, the High Court of Eastern Denmark passed judgment on liability for 11 members of Amagerbanken’s Executive Board and Board of Directors. The first instance judgment in May 2008 acquitted the defendants based on the Business Judgment Rule, which was not considered violated despite ongoing support to a large property developer and breach of internal guidelines. This decision was reversed by the High Court, and damages of approximately €30 million were awarded to the creditors in the bank’s bankruptcy. Two employee-elected board members were not found liable due to a special easing rule in Section 24(1) of Danish Liability Act, since the damages were considered exorbitant and unduly burdensome for those two persons.

VIII OUTLOOK

With recent changes to legislation now in effect, the Danish market can look forward to a period of certainty and growth in leveraged finance, particularly as growing confidence in the European market continues to be felt in Denmark.

At the moment, financial institutions both in Denmark and internationally seem eager to provide transaction finance, albeit that the remains of the financial crisis are being felt and credit departments are more vigilant and have more focus on requiring solid security packages. The new regime for when write-downs have to be taken by banks if a loan goes sour (earlier than before) also sometimes prohibits the financing of M&A transactions, as banks always consider the specific risk profile of a financing deal.
However, increased regulatory pressures from the EU and the prospect of further regulation in the future may mean the industry must stay adapted to potential changes.

Moreover, with the Danish implementation of the new Shareholder Rights Directive 2017/828/EU new rules regarding identification of shareholders, exercise of ownership rights, related party transactions as well as on the regulation on incentive remuneration will be introduced in the Danish Company Act. The implementation is planned to be completed mid-2019.
I  OVERVIEW

Acquisition finance in Germany has traditionally been dominated by loan agreements with German or Germany-based international banks, often in club deals. The spectrum has broadened and by and large all kind of financings available in the London market can be accessed in the German market as well. A large part of the leveraged loans are still structured as club deals, especially in the small and mid-cap market segment, but unitranche and super senior financings are increasing in number and volume. At the higher volume end of the market, there are typically term loan Bs (TLBs) and high-yield bonds combined with bank revolvers.

The Loan Market Association (LMA) standard documents have established themselves as the dominant documentation standard in Germany for syndicated loan facilities. The LMA published two German law precedents for investment-grade borrowers and for real estate financing. At the lower volume end of transactions, LMA-based but shortened documentation prevails that, if only German banks and borrowers are involved, is often set out in the German language.

II  REGULATORY AND TAX MATTERS

i  Licensing requirements

In contrast to other jurisdictions (e.g., England), commercial lending in Germany generally requires a banking licence. Under the German Banking Act (KWG), the extension of loans is a regulated banking activity if it is performed on a commercial basis or to an extent that requires commercial business operations. The commercial basis-test is usually met if the lending undertaking is to be conducted for a certain period of time and with the intention to generate profits. Consequently, this requirement is usually met (long) before commercial business operations are required. In practice, the latter criterion is, therefore, of little relevance. It is noteworthy that, according to the administrative practice of the German Federal Supervisory Authority (BaFin), there is no de minimis exemption for lending activities, and the licence requirement under the KWG applies irrespective of whether or not loans are extended to consumers or corporate borrowers.

In principle, only banking activities conducted in Germany are subject to the licence requirement pursuant to the KWG. Commercial lending is generally considered to be conducted in Germany if the lender has its registered seat, or a permanent establishment, in
Germany. However, the licence requirement may also be triggered if a lender does not have registered seat or a permanent establishment in Germany, but actively addresses the German market by repeatedly offering loans to individuals or legal entities situated in Germany. Where a lender does not actively address the German market, it may benefit from the ‘reverse solicitation’ exemption. Pursuant to this exemption, which is based on an established administrative practice of BaFin, no German banking licence is required for the extension of loans to borrowers situated in Germany if the extension of loans is permitted in the (foreign) jurisdiction in which the lender is situated, and the respective lending transaction has not been solicited by the lender but was provided solely upon the initiative and request of the borrower. The distinction between a reaction upon a request to provide a loan and the solicitation of a loan offer is highly fact-driven and requires an overall assessment of all circumstances of the individual case at hand.

In order to qualify as ‘lending’ under the KWG, a person or entity must grant loans, or enter into contractual obligations to grant loans. Hence, the acquisition of a loan, which has already been disbursed in full prior to such acquisition and where the purchaser is under no obligation to extend any (further) credit, does not qualify as ‘lending’ pursuant to the KWG. The mere administration of the acquired loan by the purchaser in accordance with the loan agreement does not trigger a licence requirement under the KWG. Therefore, the acquisition of fully disbursed term loans does not generally require a banking licence in respect of the purchaser. There are two important exceptions to this rule. First, a novation, prolongation or other material amendment of an existing loan is treated by BaFin as an extension of credit. As a consequence, a purchaser of fully disbursed term loans, who does not have a banking licence for lending transactions, must not enter into the aforementioned amendments or transactions in respect of the acquired loans. This, of course, limits the available options should the acquired loans, for example, need to be restructured. Second, the acquisition must not be conducted on an ongoing or revolving basis. The ongoing acquisition of loans (or other receivables) on the basis of a master agreement would require a banking licence for factoring transactions under the KWG. Last, where the purchaser of loans also acquires the role as facility agent or security agent, the exercise of such role may require a licence pursuant to the German Payment Services Oversight Act (ZAG).

Since 2016, there is a further exemption from the general rule that the extension of loans on a commercial basis requires a banking licence. This statutory exemption in the KWG is available for certain alternative investment funds (AIFs) and their managers (AIFMs), and is widely used by credit funds that originate loans within and into Germany. The exemption applies to German AIFs and AIFMs, which in turn are regulated by the German Capital Investment Act (KAGB), EU-AIF and AIFM, which are subject to the rules and regulations implementing the Alternative Investment Fund Managers Directive (AIFMD). Among other prerequisites, the loan origination must form part of the collective portfolio management of the AIF and AIFM. Third-country AIFs and AIFMs may only benefit from this exemption if they have successfully completed the notification procedure for a marketing and distribution of the respective fund in Germany with BaFin. A notification procedure for the marketing and distribution of the fund only to professional investors does not suffice for the purposes of this exemption under the KWG.
ii Taxes and fees
Interest payments under loan agreements are subject to German corporation tax if the lender is tax-resident in Germany, which, together with the solidarity surcharge, amounts to 15.825 per cent. In addition, trade tax imposed and rate set by municipalities applies (roughly between 7 and 18 per cent).

While Germany charges a withholding tax on specific capital investments, interest on loan agreements is generally not subject to withholding tax. Certain exemptions apply, for example, for certain hybrid loans (i.e., loans with an interest rate linked to the borrower's profits or liquidity). Furthermore, in the case of non-German lenders, the German tax authorities could impose a withholding tax obligation on the borrower if the interest is subject to German limited tax liability (e.g., in the case of a non-German lender if the loan is secured by German real estate). Specific attention is, therefore, required in phrasing tax gross-up and indemnity clauses.

Interest expenses are generally tax deductible in Germany. Certain exemptions apply, such as the interest barrier rule,\(^2\) which limits the tax deductibility of interest expenses in excess of the interest income to 30 per cent of the tax EBITDA of the relevant taxpayer (subject to certain exemptions), and the add-back provisions under the German Trade Tax Act. In order to achieve deductibility of interest expense of the acquiring entity taking out the financing against operating income of the target in a leveraged buyout, a tax group is usually implemented between both entities by way of a profit and loss transfer agreement. For the purposes of corporation and trade tax, the operating profit may then be set off with the interest expenses. The problem can be further mitigated by a debt pushdown, bringing part of the interest-incurring debt to the same level as the operating profit.

While loans are by default VAT exempt, lenders may opt to charge VAT on interest payments. As it might be unclear whether the borrower is entitled to a corresponding VAT credit (in the absence of which the VAT paid to the lender would be a definite cost item), such an option is typically excluded from VAT gross-up in loan agreements.

There are no stamp duties payable in Germany. There are notarisation and registration fees in connection with share pledges over limited liability companies and land charges. Notarisation of share pledges may trigger notarisation fees – the registration or assignment of land charges in the land register and the submission to immediate enforcement trigger registration and notarisation fees, respectively. Fees depend on the value of the collateral asset.

With respect to the US Foreign Account Tax Compliance Act (FATCA), it is not required for German lenders to enter into FATCA agreements. Instead they are obliged to make certain reports. Nevertheless, it is typical for LMA-based documentations to include FATCA wording, usually based on the LMA wording for allocating FATCA risks to lenders.

iii Sanctions
It is typical for facility agreements to contain representation and undertakings regarding compliance with domestic, EU, UN and US sanctions. As many German banks have US branches or subsidiaries, these provisions can also be found in facilities agreements governed by German law or made for German club deals. Compliance with these sanctions, specifically with US economic and trade sanctions that have extraterritorial reach and are administered

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\(^2\) Note that the German Federal Fiscal Court considers the interest barrier rule unconstitutional and has referred the case to the German Federal Constitutional Court.
and enforced by the US Office of Foreign Assets Control (OFAC) is, however, problematic. German and EU blocking laws prohibit participation in foreign boycott measures (i.e., sanctions that are not UN, EU or German).

EU regulation (EC) 2271/96 and the German Foreign Trade Ordinance prohibit entities located in the EU or Germany, respectively, from complying with sanctions that are not recognised by Germany or the EU (these are most notably OFAC-administered sanctions). Compliance with UN, EU and German sanctions is unproblematic, and the relevant representations and undertakings in finance documents are phrased accordingly.

German borrowers and guarantors typically request carveouts from sanction covenants in the credit documentation so that they do not need to comply with sanctions going beyond those from the EU, UN and Germany. German banks also require that they be carved out so that the representations and undertakings are not given to them. An alternative to including carveouts is entering into a side letter providing for full sanction compliance (including OFAC) but which is only signed by non-German borrowers, guarantors and lenders. Awareness that these carveouts might be needed not only for German, but also for other European borrowers, guarantors or lenders is increasing in recent times, and occasionally carveouts extending to European members of a borrower group or non-German European banks, can be seen.

III SECURITY AND GUARANTEES

i Types of security and guarantees

In contrast to some common law jurisdictions like England, there is no ‘all-asset’ type of security instrument available in Germany. Rather, security has to be taken over each asset class individually by separate security documents. Generally speaking, security can be granted over almost all kinds of assets but some are more burdensome and costly than others. Due diligence is, therefore, required to establish what kind of assets are available and whether taking security over them is appropriate from a cost and benefit perspective.

Typical German security instruments for a financing comprise the following:

<table>
<thead>
<tr>
<th>Asset type</th>
<th>Form of security instrument</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares</td>
<td>Pledge</td>
<td>GmbH shares can only be pledged by notarial deed incurring notarial fees</td>
</tr>
<tr>
<td>Bank accounts</td>
<td>Pledge</td>
<td>Requires notice to account bank. Restrictions on payments or transfers can be imposed by lender</td>
</tr>
</tbody>
</table>

3 Article 5 of EU regulation (EC) 2271/96 of the European Council of 22 November 1996, protecting against the effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

4 According to Section 7 of the German Foreign Trade Ordinance, German-based persons (e.g., borrowers, guarantors) may not give declarations to enter into or comply with a trade boycott unless the trade boycott is in accordance with sanctions imposed by the UN, the EU or Germany. It is further unlawful for anyone (Germany-based or not) to request a Germany-based person to adhere to trade boycotts that are in accordance with sanctions imposed by the UN, the EU or Germany. Violation may result in a fine of up to €500,000 or, under specific circumstances, criminal liability.

5 All asset security in England and Wales is typically taken by way of a floating charge.
There are no restrictions on granting security over real estate to foreign lenders; however, this might have adverse tax consequences. The grant of security over real estate and shares in a Gesellschaft mit beschränkter Haftung (GmbH), namely a German limited liability company, requires notarisation, which will involve the payment of notary's fees. In addition, security over real estate requires registration in the land register, which will involve registration fees. The notarisation and registration fees are determined by statute and can be substantial.

In addition to in rem security, it is common that the material members of the borrower group grant guarantees for all loans outstanding under the relevant facility agreement.

ii Accessory or non-accessory nature of security

German law security interests are either accessory or non-accessory in nature. Accessory security interests are closely linked to, and share the fate of, the underlying secured claim. Accessory security interests do not come into existence without a valid secured claim and cease to exist, by operation of law, as soon as the relevant secured claim has been extinguished. A creditor cannot benefit from accessory security unless it is also the holder of the secured claims. As a consequence, accessory security interests will be automatically transferred together with the underlying secured claim and cannot be separately transferred. Non-accessory security interests, on the other hand, are independent of the underlying secured claim. They are more flexible from the perspective of the secured creditor. Non-accessory security interests need to be re-transferred or reassigned to the relevant security provider and do not automatically lapse upon extinguishment of the underlying secured claim. Mortgages and pledges are accessory security interests, whereas assignments and transfers for security purposes as well as land charges belong to the group of non-accessory security interests. Owing to their nature, there are different requirements for the creation, enforcement, release and transfer of accessory security versus non-accessory security that need to be observed.

iii Security agent and parallel debt

Non-accessory security is not linked to the holding of a claim and the security can, thus, be held by a person other than the creditors of the secured claims. Holding and administering of non-accessory security by security agents acting for the lenders is, therefore, straightforward. Accessory security on the other hand requires that the person holding the security is itself also the holder of the secured claim. A security agent is, however, not a creditor of the loans.

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6 See Section II.ii.
7 See Section III.v.

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under a facilities agreement made by the lenders. In order to allow the lenders to benefit from the accessory security, the security agent will commonly be granted a parallel debt obligation by the borrowers and guarantors in the amount of the debt under the finance documents. This artificially created obligation at the level of the security agent will then be secured by the accessory security. The parallel debt is in the same amount and payable at the same time as the obligations of the borrowers and the guarantors under the finance documents. Any payment of such underlying obligations will discharge the corresponding parallel debt and, vice versa, any payment in respect of the parallel debt will discharge the corresponding underlying obligations. The parallel debt is usually established in the intercreditor agreement or security agency agreement but can also be created in the facilities agreement or a separate document.

While the parallel debt concept is widely used as a standard to secure financings, the legal concept of creating parallel debt obligations in syndicated lending has not yet been tested before a German court. To mitigate such risks, it is not uncommon to secure, in addition to the security agent, the lenders directly.

iv Transfer of security and amendment of finance documents

Under German law, a transfer of secured claims will not automatically result in the transfer of all types of German security and, in some cases, can result in the automatic extinguishment of that security. Similarly, certain amendments to facility agreements may affect the validity of German guarantees and security.

Non-accessory security is usually granted to a security agent and remains unaffected in the event of a loan participation being transferred to a new lender, whether by way of assignment or novation. Accessory security rights share the fate of the underlying secured claim. If a lender has been directly secured by accessory security, the security interest will pass over to the new lender if the underlying loan claims are assigned to the new lender or the loan participation is transferred by way of assumption of contract. However, if the loan participation is transferred by way of novation (as is often the case under English law facility agreement), whereby the original loan claims are extinguished and then re-established with the transfer as new creditor, the accessory security interest will be extinguished.

To enable the transfer of loan participations without a risk of security ceasing to exist, two remedies are used in German lending practice. The most common one is to also secure the security agent via a parallel debt obligation as explained in Section III.iii. The other remedy is to include a ‘future pledgee’ concept whereby the security agent accepts the accessory security as representative for each future, yet unknown, secured party. The future secured party ratifies the granting of accessory security once it accedes to the finance documents at the time it acquires a loan participation. From a German perspective, it is also recommended not to use novations for loan transfers but only assignments or assumptions of contracts.

Further, amendments, term extensions or fee and interest increases must be structured in a way to ensure that guarantees and security are extended to the amended or increased obligations. There is certain doubt to which extent security grantors and guarantors are able to secure future unforeseeable debt. To mitigate this risk, it is market practice to confirm or redo German law security and expressly extend the security to the amended or increased secured obligations. Non-accessory security will be confirmed by confirmation agreements. For accessory security like pledges, new junior ranking security will be granted on top of the existing accessory security (known as ‘supplemental pledges’). The latter might result in significant notarial fees in relation to share pledges over a GmbH.
v Enforcement of security interests

The enforcement of security interests depends on the type of security and the specific asset class over which security has been taken.

To enforce accessory security in the form of pledges, the underlying secured obligation has to become due and payable.\(^8\) This means an enforcement is not possible if only certain covenants or undertakings have been breached but the loans have not been accelerated or other payment claims have become due.PLEDS over rights (such as bank accounts or IP) theoretically require that the secured party obtains an enforceable instrument.\(^9\) This requirement is, however, mostly waived in security agreements. The enforcement procedures are stipulated by law and typically require public auction\(^10\) unless the assets have a value determined at a stock exchange or other predetermined market price.\(^11\) Pledges over receivables or bank accounts give the secured party a collection right of the claims against the third-party debtor or bank.\(^12\)

German law does not contain requirements for the enforcement of non-accessory security (other than security over real estate). The parties are generally free to agree on enforcement triggers and procedures. The collateral is typically sold or auctioned subject to the enforcement procedures agreed upon in the security documents.

Enforcement of real estate security (i.e., land charges or mortgages) will be carried out by the lender in accordance with the German Foreclosure Act\(^13\) by way of a forced auction (compulsory sale) of the property. An application for foreclosure requires filing of an original enforceable instrument. To avoid court proceedings at the time of enforcement, the enforceable instrument is obtained when the real estate security is granted by way of a submission by the landowner to immediate foreclosure in the notarial land charge deed. In addition, a land charge or mortgage must be terminated before enforcement. The mandatory termination notice period is six months, causing significant delay in the enforcement procedures.\(^14\)

Irrespective of the legal requirements, security agreements for financings usually contain preconditions before the security can be enforced, which are similar or identical across the different types of security. Typically, the borrower must be in payment default or declared default must have occurred. Generally, the lender must give notice of enforcement to the grantor of the security before starting enforcement procedures.

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8 Section 1228, paragraph 2 of the German Civil Code.
9 Section 1277 of the German Civil Code.
10 Section 1235 of the German Civil Code.
11 Section 1221 of the German Civil Code.
12 Section 1282 of the German Civil Code.
13 Zwangsversteigerungsgesetz (ZVG).
14 Section 1193 of the German Civil Code.
vi Most relevant limitations on granting security interest

First-demand guarantees

German courts regard guarantees on first demand (i.e., on a mere assertion of a claim or production of a document) as potentially dangerous for the guarantor. Pursuant to case law, guarantees of first demand granted by individuals or companies inexperienced in international trade or finance are invalid. The same applies to guarantees of first demand, which are contained in general terms and conditions.

Over-collateralisation

German law security arrangements are deemed void if the total security taken is far in excess of the secured obligations at the time the security arrangements are entered into (initial over-collateralisation). Initial over-collateralisation is generally held to occur if at the time of entering into the security agreement it is certain that in the event of a foreclosure there will be an obvious imbalance between the realisable value of the collateral and the secured claims. There is no clear case law guidance on thresholds, but invalidity of the security is often assumed when the realisable value of the collateral exceeds the cover threshold (which is generally held to be 150 per cent of the nominal amount of the secured claims) by more than 200 per cent (i.e., the realisable value would be in excess of 300 per cent of the nominal value of the secured claims). Because of the relatively high thresholds, initial over-collateralisation is rarely an issue, but should always be considered when structuring security packages for loan financings.

While initial over-collateralisation always voids a security agreement, in a scenario where over-collateralisation only occurs during the term of a loan financing (e.g., by scheduled repayment of the loans), the security agreements are not deemed to become void. Pursuant to case law, for security interests which do not initially, but over the duration of the security arrangement, provide for security in a nominal value in excess of 150 per cent of the secured obligations and in a realisable value in excess of 110 per cent of the secured obligations, the security grantor obtains a right to request release of part of the collateral until the value of the collateral falls below the thresholds. As a result of the impracticalities of release and potential recreation of security, such a right to release is rarely exercised in practice.

Capital maintenance rules and financial assistance

Under German capital maintenance rules, a GmbH or a German stock corporation may secure or guarantee its own debt and that of its subsidiaries without limitation. Debt of a German limited liability company’s direct or indirect shareholders and their affiliates can only be secured up to the amount of equity a shareholder is able to take out of the company granting the security. This means, in effect, that sufficient assets have to remain in the company so as to cover the debt of all other creditors. The commercial result of a limitation language reflecting these provisions is that all other creditors of the company become factually ranking prior to financial creditors benefitting from upstream security. A German stock corporation may, under capital maintenance rules, not grant any benefits to its shareholders.

15 See, for instance, BGH, decision dated 23 January 1997, IX ZR 297/95.
16 This includes partnerships that include a GmbH as a general partner.
17 Aktiengesellschaft (AG).
18 Section 30 of the German Limited Liability Companies Act.
(or any affiliates of its shareholders) except for the payment of dividends from the annual profits of the stock corporation.\textsuperscript{19} These restrictions, however, do not apply if a domination or a profit-and-loss-transfer agreement has been entered into between the limited liability company or stock corporation as security grantor and its shareholder or if the security grantor has a fully valuable compensation claim against that shareholder.\textsuperscript{20}

A breach of capital maintenance rules would usually not render the security or guarantee invalid but the shareholder would have to compensate the company for any over-enforcement and the management of the company granting unlimited security or guarantees would become personally liable. To avoid these consequences, it is common market practice to include limitation language into security and guarantees granted by German entities with limited liability, which limits the enforcement to the legally permitted level subject to certain exceptions.\textsuperscript{21} The details of a limitation language are typically discussed in detail and at length. In addition, German stock corporations are subject to a strict financial assistance prohibition. This does not only comprise direct assistance to finance the acquisition of its own shares but also indirectly by way of upstream security and guarantees in respect of acquisition debt.\textsuperscript{22}

\textbf{Debt pushdown}

A debt push is often employed to overcome the restrictions of upstream guarantees and security (see above) and the resulting ‘structural subordination’ of creditors of acquisition debt. A debt pushdown is implemented by way of assumption of contract by the relevant target company. The extent to which a pushdown of acquisition debt can be implemented is also subject to corporate law requirements and needs to be analysed in detail in the light of the balance sheet situation and the tax affairs of the relevant group.

\textbf{Destructive interference, bonos mores and inducement to breach of contracts}

In addition to capital maintenance requirements, the German Federal Supreme Court has developed a concept of ‘destructive interference’\textsuperscript{23} (i.e., a situation where a shareholder deprives an entity of the liquidity necessary for it to meet its own payment obligations).\textsuperscript{24} This concept may be applied by courts with respect to the granting of guarantees or security by a German entity for securing debt of its shareholder.

Furthermore, the beneficiary of a transaction effecting a repayment of the stated share capital of a GmbH could become personally liable under exceptional circumstances. The German Federal Supreme Court ruled that this could be the case if, for example, the creditor taking security were to act with the intention of detrimentally influencing the position of the

\begin{itemize}
\item Section 57 of the German Stock Corporations Act (AktG).
\item Section 30 of the German Limited Liability Companies Act (GmbHG). See Heidinger, \textit{Kommentar zum Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbH-Gesetz)}, 3rd Edition, Section 30, No. 89, for further details.
\item German limitation languages usually contain certain carve outs and adjustments which deviate from the enforceable level stipulated by law but which shall ensure that the management of the company granting security complies with its obligations under the Finance Documents as it would otherwise become personally liable under capital maintenance laws.
\item Section 71a of the German Stock Corporations Act (AktG).
\item \textit{Existenzvernichtender Eingriff}.
\item BGH, decision dated 16 July 2007, II ZR 3/04.
\end{itemize}
other creditors of the debtor in violation of the legal principle of bonos mores.\textsuperscript{25} This intention can be deemed to be present if the beneficiary of the transaction was aware of circumstances indicating that the grantor of the guarantee or collateral was close to financial collapse.

According to a decision of the German Federal Supreme Court, a security agreement may be void because of tortious inducement of breach of contract if a creditor knows about the distressed financial situation of the debtor and anticipates that the debtor will only be able to grant collateral by disregarding the vital interests of its other business partners.

\textbf{vii Claw-back rights in insolvency proceedings}

Under the German Insolvency Code, the insolvency administrator (or in the case of debtor-in-possession proceedings, the custodian) may challenge transactions, performances or other acts that are deemed detrimental to insolvency creditors and that were effected prior to the opening of formal insolvency proceedings during applicable hardening periods. Generally, if transactions, performances or other acts are successfully challenged, any amounts or other benefits derived from the challenged transaction, performance or act will have to be returned to the insolvency estate.

An act or a legal transaction (which includes the granting of a guarantee, the provision of security and the payment of debt) detrimental to the creditors of an insolvent entity may be challenged in the following most relevant situations.

\textit{Congruent coverage (Section 130 Insolvency Code)}

Transactions providing the creditor with security or satisfaction for its claims if:

\begin{itemize}
  \item[a] the relevant transaction was entered into within three months prior to the filing for insolvency, the debtor, at the time of the transaction, had already been illiquid and the creditor had positive knowledge thereof;\textsuperscript{26} or
  \item[b] the relevant transaction was entered into after the filing for insolvency and, at the time of the transaction, the creditor had positive knowledge of the debtor’s illiquidity or of the fact that an application for the opening of insolvency proceedings had previously been filed.\textsuperscript{27}
\end{itemize}

\textit{Incongruent coverage (Section 131 Insolvency Code)}

Transactions providing the creditor with security or satisfaction for its claims to which the creditor was not entitled at that time or not in that manner are subject to claw-back if:

\begin{itemize}
  \item[a] the relevant transaction was entered into during the last month preceding the filing for insolvency or thereafter;\textsuperscript{28}
  \item[b] the relevant transaction was entered into during the second or third month prior to the filing for insolvency and the debtor, at the time of the transaction, was already illiquid;\textsuperscript{29} or
\end{itemize}

\begin{footnotes}
\item[26] Section 130(1), No. 1 of the German Insolvency Code.
\item[27] Section 130(1), No. 2 of the German Insolvency Code.
\item[28] Section 131(1), No. 1 of the German Insolvency Code.
\item[29] Section 131(1), No. 2 of the German Insolvency Code.
\end{footnotes}
the relevant transaction was entered into during the second or third month prior to the filing for insolvency and the creditor, at the time of the transaction, had positive knowledge that the transaction was detrimental to the insolvency creditors.30

**Transaction without consideration (Section 134 Insolvency Code)**

Transactions without (adequate) consideration (e.g., where a debtor grants security for a third-party debt, which might be regarded as having been granted gratuitously), if granted within four years prior to the filing for insolvency

**Wilful damage (Section 133 Insolvency Code)**

Transactions providing the creditor with security or satisfaction for its claims within the four years prior to the filing for insolvency or thereafter if the debtor acted in bad faith with the intention to harm its creditors and the creditor receiving the security or satisfaction was aware of the debtor’s intention (such knowledge being assumed or indicated under certain circumstances).31

An important option to avoid claw-back risks for security or guarantees in a financing transaction is to structure of security and guarantees as ‘cash transactions’. A transaction is considered a cash transaction if the debtor receives a consideration of equal value in return for and concurrently with its own performance (e.g., the debtor grants security for a new loan within a short period of time after disbursement of the funds).

## IV PRIORITY OF CLAIMS

### i Ranking of claims and security

Under German law, all claims, whether secured or unsecured, have the same ranking unless subordinated by contract or law. The most common method of ranking is a contractual subordination by way of a subordination or intercreditor agreement between the various creditor classes and the respective borrowers. Structural subordination is also employed specifically in larger volume deals with multilayer financing structures. Contractual and structural subordination are often combined. Documentation is typically based on LMA standards with shorter versions for lower mid-cap deals.

Whether security can be created in first, second and further ranking form depends on the type of security. Accessory security like pledges can be created for different creditors in different rankings. Non-accessory security like receivables assignments can only be granted to one secured party as first ranking security. For layered financings, which would typically also have layered security packages (e.g., senior and mezzanine), pledges over shares, bank accounts and release estate can be granted separately for each creditor class. However, for non-accessory security such as receivables and inventory assignments, the security would need to be granted to one common security agent with ranking to be achieved via the intercreditor agreement. The common practice for most financings in Germany has evolved into pooling

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30 Section 131(1), No. 3 of the German Insolvency Code.

31 The previous hardening period was 10 years, which has been reduced by the insolvency clawback reform, which became effective on 5 April 2017.
security at one security agent with one intercreditor agreement for all layers of creditors and debt. Parties rely on the contractual agreement in the intercreditor agreement on ranking and waterfall.

In the event of debt increases and term extensions, it is common practice in Germany to confirm non-accessory security and grant junior ranking accessory security (supplemental pledges, see Section III.iv) to ensure that the increased or extended debt is covered by the security agreements.

ii Impact of the German insolvency regime on secured creditors

All creditors, whether secured or unsecured, need to participate in the insolvency proceedings. Secured creditors are generally not entitled to enforce any security interest outside the insolvency proceedings. In the insolvency proceedings, secured creditors have certain preferential rights. Depending on the legal nature of the security interest, entitlement to enforce such security is either vested with the secured creditor or the insolvency administrator. If the secured creditor has a preferential right to enforcement or has a separation right, it may enforce its security by itself. Regarding preferential rights, the insolvency administrator generally has the right to realise any movable assets in the debtor's possession that are subject to security, as well as to collect any claims that are subject to security assignment agreements. If the enforcement right is vested with the insolvency administrator, the enforcement proceeds, less certain contributory charges (usually up to 9 per cent of the gross enforcement proceeds), are disbursed to the party secured by the security interests. With the remaining enforcement proceeds and any unencumbered assets of the debtor, the insolvency administrator satisfies all creditors (whether secured or unsecured) rateably.

iii Equitable subordination of shareholder loans

Claims for repayment of shareholder loans are subordinated in a German company's insolvency and treated, in effect, as if the loan amount was contributed as equity.32 Prior to an insolvency, a shareholder loan can be repaid at any time with basically no restriction. However, repayments made under a shareholder loan, whether due or not, within the year before the application to open insolvency proceedings can be challenged by the insolvency administrator and would need to be paid back to the insolvency estate.33 Exceptions apply for loans granted by shareholders who (1) do not participate in the management of the company and who hold not more than 10 per cent of the capital of the company or (2) have acquired the shares in order to rescue the company in a financial crisis.34

As the rules on equitable subordination only apply in an insolvency of a borrower, a borrower may make payments on a shareholder loan prior to its insolvency (subject to hardening periods of one year). Thus, in financing structures it is common for shareholders to agree with the lenders that shareholder loans are contractually subordinated and that (except for interest in certain cases) no payments will be made on the shareholder loans as long as the debt financing remains outstanding.

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32 Section 39(1), No. 5 of the German Insolvency Code.
33 Section 135(1), No. 2 of the German Insolvency Code.
34 Section 39(4)–(5) of the German Insolvency Code.
Pursuant to case law, even third-party lenders may be treated as shareholders in exceptional circumstances and thereby become subordinated. This is the case when lenders would have an influence over the borrower to an extent that they take over its day-to-day management. It is disputed whether by tight covenants as contained in template LMA documentation, lenders limit the corporate and commercial flexibility of borrowers to such an extent triggering the case law subordination. Representations and undertakings should, therefore, provide borrowers with sufficient flexibility to manage their day-to-day business. Sometimes, German obligors are carved out from specific covenants, but those apply indirectly to them via information undertakings to the lenders, which then have an option to consider cancellation for good cause.

V JURISDICTION

i Choice of governing law

Generally, courts in Germany will uphold the choice of law of foreign law governing loan agreements. The application of foreign law to agreements is governed by the Rome I Regulation. A choice of foreign law will only then not be upheld of in the event of a conflict with public policy or overriding mandatory provisions of German or foreign law. A choice of law regarding non-contractual obligations is subject to the provisions of the Rome II Regulation and similar restrictions as under the Rome I Regulation. Under the conflict of law rules of Germany and the European Union, the lex rei sitae principle applies to all rights in rem, and German law may under those provisions also be applied to security interests over non-physical assets such as receivables governed by German law. Security over German collateral is, therefore, generally subject to German law.

ii Choice of venue

A choice of venue is possible under German and European law subject to certain limitations. An agreement on a place of venue could be blocked by provisions of German law and the Brussels I Regulation, determining exclusive venues for certain matters (e.g., disputes concerning the ownership of immovable property, employment contracts, the existence of a company or the validity of registrations in public registers).

iii Enforcement of foreign judgments

The requirements for enforcement of foreign judgments depend on the country of the ruling court. Enforcement of judgments of courts of member states of the European Union of the European Economic Area are subject to the provisions of the Brussels I Regulation.

37 Article 9 of Regulation (EC) No. 593/2008.
or the Lugano Convention,\textsuperscript{40} respectively, which are largely the same. Judgments of such countries will be recognised and are enforceable in Germany without separate declaration of enforceability by a German court. Judgments from other countries require a declaration of enforceability by a German court, and their recognition is subject to the provisions of the German Code of Civil Procedure,\textsuperscript{41} which require, inter alia, that the country of origin of the judgment would recognise and enforce German judgments on generally equivalent conditions (reciprocity).

VI ACQUISITIONS OF PUBLIC COMPANIES

Public companies are usually organised as stock corporations, a partnership limited by shares or a European company.\textsuperscript{42} These entities are subject to the Stock Corporation Act or the Regulation on European Companies.\textsuperscript{43} Transactions in the capital markets are regulated by the Securities Trading Act.\textsuperscript{44}

The takeover of listed public companies in Germany is regulated by the Takeover Act.\textsuperscript{45} The Act and supplemental guidelines set out the rules for the consideration, the content of the offer and the offer procedure.

According to German law, a person obtaining the direct or indirect control over a listed company has to submit a mandatory offer for the acquisition of all shares in the target company. Control is assumed if 30 per cent or more of the voting rights are acquired by a person. Voting shares of subsidiaries and persons acting in concert are attributed to the acquiring person under certain conditions. An enforcement of security over shares in a listed public company may also trigger a mandatory offer for the acquirer that needs to be taken into account when structuring security packages. There is no obligation to make a mandatory offer if the control over the target company was reached by way of a voluntary takeover offer. Exemptions from a mandatory offer may be granted by BaFin. The takeover offer must stipulate a consideration at a certain minimum price as regulated in an ordinance (higher of the average share trading price of the past three months and the highest price paid by the bidder during the past six months).\textsuperscript{46}

Voluntary offers generally follow the same rules as mandatory public offers. The bidder may freely set the purchase price unless the offer may lead to acquiring control in the target. A mandatory or voluntary offer may not be made subject to financing. The bidder has to have financing agreements in place ensuring payment assuming that all shares are tendered.\textsuperscript{47} The bidder has to specify in the offer how its financing is ensured. The financing arrangements must provide the bidder with certain funds that are definitely available if and

\textsuperscript{40} Convention on jurisdiction and recognition and enforcement of judgments in civil and commercial matters dated 30 October 2007.
\textsuperscript{41} Section 328 of the German Code of Civil Procedure.
\textsuperscript{42} Stock company, Partnership limited by shares and societas Europaea.
\textsuperscript{44} Wertpapierhandelsgesetz (WpHG).
\textsuperscript{45} Wertpapiererwerbs- und Übernahmegesetz (WpÜG).
\textsuperscript{46} Takeover Act Offer Ordinance (WpÜG-AngebotsVO).
\textsuperscript{47} Section 13 of the German Securities Acquisition and Takeover Act.
when the offer closes. For considerations in cash, a written confirmation has to be provided by an independent securities services provider (a ‘financing confirmation’) that the bidder has taken all necessary measures in order to ensure that the funds required are available for the complete fulfilment of the offer at the time the consideration becomes due.

All shareholders have to be treated equally in an offer. The offer may be made conditional in certain respects. For example, essential antitrust conditions are accepted by the authorities. The conditions have to be objective, and the offeree has to be able to make an informed decision on the basis of the information provided. A valid condition may be that shares in excess of a minimum threshold are acquired. In practice, takeovers are often conditional on the acquisition of at least 75 per cent of the voting shares, enabling the bidder to reorganise the target group. Once the bidder has announced its decision to make a takeover offer it is obligated to execute the further offering procedure. The offer may only expire if conditions relating to it are not fulfilled.

VII THE YEAR IN REVIEW

The high volumes and strong deal count of 2017 for leveraged finance transactions in Europe and Germany continued at a high level in 2018, albeit not reaching new heights. Structures suffered again in 2018, with ongoing dilution of lender protections. Conversion from maintenance to incurrence covenants accelerated, and the percentage of covenant lite loans rose still further. This is especially true for larger mid-cap, large cap and leverage/investment grade crossover financings. For mid-cap and smaller deals, covenants have also become looser but continue to apply with maintenance testing. A leverage covenant remains the norm, but a second or third financial covenant has become rare. On the other end of the spectrum, crossover deals are moving to look increasingly like corporate financings. This environment continues, driving a large number of refinancings, which is responsible for a large share of the issuance volume. Availability of funding in Germany is not only driven by the strong domestic bank market, but also by an increasing push of debt funds into Germany. Since their appearance in the market in 2013, debt funds have reached parity in unitranche deal count in 2018.

VIII OUTLOOK

Despite economic growing uncertainty, it seems that the favourable and borrower-friendly conditions in the German lending market will continue for the time being. A number of developments in recent documentation addressed flaws in standard finance documentation that were simply too tight for borrower groups to prosper and develop. We would expect those to stay. On the other hand, increasing numbers of restructuring situations and concerns for the general economic outlook might result in more robust covenant protection for lenders in new finance documentation. Debt funds will continue to provide a large and even increasing part of the financings in the small and mid-cap space while the predominance of banks as arrangers and underwriters in the upper mid-cap and large cap segment will continue.

48 Conditions are only permitted to a very limited extent. For more detail, see Baums, Thoma, WpÜG – Kommentar zum Wertpapiererwerbs- und Übernahmegesetz, 8th delivery, Section 13, No. 191.
Chapter 10

HUNGARY

Melinda Pelikán, János Pásztor, László Lovas and Bence Kálmán

I OVERVIEW

After the crisis, the number of financing transactions in Hungary (especially acquisition and project financing) radically dropped. Since that time the situation has changed again, and in the past four to five years the banking sector has come alive again and the appetite of banks for financing (especially for acquisition finance) has started to increase. Such increase was partly because of the financing programme introduced by the National Bank of Hungary (NBH) in June 2013, which aimed to help small- and medium-sized enterprises and offered a 2.5 per cent fixed interest rate on 10-year loans.

In Hungary, acquisition finance is typically made via bank loans. The composition (i.e., domestic, international or both) and the number of banks strongly depends on the size of the assets to be acquired and the volume of the transaction. The bigger the deal, the more probable it is that the financing banks are from an international background.

Note or bond issuance is used for foreign financiers and for high-volume transactions.

Other financing instruments (super senior revolving credit facilities, second lien loans, mezzanine loans, PIK loans/bonds, etc.) are not very common in Hungary, and are usually used if the transaction is a cross-border acquisition and one or more of the subsidiaries of the target company is Hungarian.

II REGULATORY AND TAX MATTERS

i Licensing requirements

According to Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (the Banking Act), providing loans regularly (‘in a business-like manner’) is a licensable activity in Hungary, except for group financing provided by an entity that is not a financial enterprise. However, the Banking Act expressly provides a definition for group financing, and consequently not all types of group financing fall within the scope of this exception.

1 Melinda Pelikán and János Pásztor are senior associates and László Lovas and Bence Kálmán are associates at Wolf Theiss Faludi Erős Attorneys at Law.

2 Section 5(2) of the Banking Act.

3 Section 6(1), point 11 of the Banking Act: ‘group financing’ shall mean a financial arrangement between a parent company and its subsidiary or between subsidiaries that is carried out collectively to ensure liquidity.
As stated above, debt finance may only be provided by:

- a financial institution incorporated in Hungary, holding a licence issued by the NBH; or
- any financial institution that is not incorporated in Hungary and that has duly passported its foreign licence to Hungary by way of a branch office or as a cross-border activity.

It is important to note that a licence is only required if the granting of loans is pursued as a business activity. The NBH issued various (non-binding) guidelines in respect of the interpretation of ‘business activity’, each of which emphasise that the three elements of such definition (i.e., regularity; for compensation; and without individual negotiation) shall be taken into consideration jointly. In other words, if any of such three elements is missing, the respective financial service probably cannot be considered as being provided as a business activity. Usually one-off lending does not trigger the licensing requirement in Hungary.

Notwithstanding, given that such guidelines are non-binding and each and every case is different, for non-bank lenders it is advisable to request a separate guideline from the NBH for the respective transaction.

ii Sanctions

No special rules or regulations with respect to anti-corruption and money laundering are applicable to acquisition finance; in this case, the general rules shall be complied with.

Banks, however, shall take into consideration international sanctions that might have an effect on the lending. Also, internal policies of the banks may prescribe that certain activities (in particular gambling, production of weapons, etc.) or offshore companies cannot be financed.

iii Other regulatory concerns

For M&A transactions using a share deal, the following regulatory issues shall be considered:

Financial assistance issues

Financial assistance rules that are currently applicable in case of the acquisition and financing of public companies limited by shares (for further details see Section III).

Competition law issues

In accordance with Hungarian competition laws, concentration of companies shall be notified to the Hungarian Competition Authority (HCA) in order to obtain consent from HCA to this concentration if the combined net turnover of all groups of companies involved, and the net turnover of the companies controlled jointly by members of the groups of companies involved with other companies of the previous financial year, exceeded 15 billion forints, and among the groups of companies involved there are at least two groups with net turnover of 1 billion forints, or more in the previous year together with the net turnover of companies controlled by members of the same group jointly with other companies.

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Section 6(1), point 116 of the Banking Act: ‘business activity’ shall mean gainful (for-profit) economic activities performed on a regular basis for compensation, involving the conclusion of deals that have not been individually negotiated.
An acquisition of regulated entities (financial institutions, insurance companies, investment firms, energy providers, etc.) is subject to the consent of sectoral authorities in addition to the consent of the HCA. In particular, in the financial sector, in order to acquire 10 per cent or more of the direct or indirect ownership in a financial institution, the NBH’s prior consent is required to such acquisition. The same applies for insurance companies and investment firms. In case of natural gas companies, the prior approval of the Hungarian Energy and Public Utilities Office shall be required for the acquisition of control of more than 25, 50 or 75 per cent of the voting rights in such a natural gas company, and for the exercise of the rights associated therewith. For electricity companies, the prior approval of the Hungarian Energy and Public Utilities Office shall be required for the acquisition of control of more than 25, 50 or 75 per cent of the voting rights in such an electricity company, and for the exercise of the rights associated therewith.

iv Overview of tax issues

Where acquisition financing is concerned, limitations on interest deduction and debt push-down are the most relevant issues that investors usually face when evaluating the Hungarian tax implications of loan financing.

Interest deduction limitation rules

As of 1 January 2019, Hungary implemented the interest limitation rules set out in Council Directive (EU) 2016/1164 of 12 July 2016 (ATAD) laying down rules against tax avoidance practices that directly affect the functioning of the internal market, which, in essence, replace the thin-capitalisation rules.5 However, according to Section 29/A(73) of the Act on CIT, as a general rule, the thin-capitalisation rules remain applicable to agreements concluded before 17 June 2016 under which financing expenses (defined above) are incurred.

According to Act LXXXI of 1996 on the Corporate Income Tax and Dividend Tax Act (the Act on CIT), the excess financing costs, that is, the amount of the net financing costs exceeding the higher of the following increases the pre-tax profit: (1) 30 per cent of the EBITDA; or (2) the statutory threshold of 939.81 million forints.6 Inter alia, the following items should be taken into account as financing costs: interest expenses, also, any costs and expenses equivalent to interest in economic terms, as well as costs and expenses incurred in connection with the raising of finance.7 The amount of the net financing costs is equal to the aforementioned financing costs less interest income and other economically equivalent taxable income.8

If the taxpayer is a member of a consolidated group for financial accounting purposes, then it may deduct the net financing costs from its CIT base in an amount equal to ratio of the net financing costs of the group vis-à-vis third-parties over the EBITDA of the group multiplied by the EBITDA of the taxpayer.9

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5 However, according to Section 29/A(73) of the Act on CIT, as a general rule, the thin-capitalisation rules remain applicable to agreements concluded before 17 June 2016 under which financing expenses (defined above) are incurred.
6 Section 8(1)(f) of the Act on CIT.
7 Point 50 of Section 4 of the Act on CIT.
8 Point 51 of Section 4 of the Act on CIT.
9 Section 8(5)(a) of the Act on CIT.
The unused interest deduction capacity can be carried forward, namely the amount can be used to reduce the excess financing costs in the subsequent tax year or years, but this reduction cannot exceed the amount of the excess financing costs.\textsuperscript{10} The interest deduction capacity of a given tax year is 30 per cent of the pertaining EBITDA less the net financing costs incurred for that tax year.\textsuperscript{11}

If the CIT base was increased in accordance with the above, the CIT base can be reduced by up to the amount of the increase in the subsequent tax year or years; however, its amount may not exceed the interest deduction capacity calculated for the tax year in which such reduction is applied.\textsuperscript{12}

The interest deduction limitation does not apply to taxpayers that, based on the relevant financial regulatory legislation, qualify as financial institutions, investment enterprises, alternative investment funds, the management companies of undertakings for collective investment in transferable securities, insurance companies or reinsurance companies.\textsuperscript{13}

Furthermore, if the taxpayer is a member of a consolidated group for financial accounting purposes and it can demonstrate that the ratio of its average equity over its average total assets is equal to or higher than the equivalent ratio of the group, then it does not have to apply the interest deduction limitation rule.\textsuperscript{14}

\textbf{Withholding tax on interest}

There is no Hungarian withholding tax on interest paid to domestic or foreign entities. However, interest paid to private individuals should be subject to a Hungarian withholding tax at 15 per cent. Tax treaties may override Hungarian domestic law with respect to the withholding tax on interest.

\textbf{Transfer pricing considerations}

Transfer pricing rules should apply if the acquisition financing takes place by means of an intercompany loan. This means that the interest rate applied on intercompany loans should be at arm’s length in order to avoid any transfer pricing adjustments. Under Hungarian transfer pricing rules, downward transfer pricing adjustments can be made only if:

\begin{itemize}
  \item[a] the other contracting party is either a domestic entity or a foreign company (except for a controlled foreign company) that is subject to corporate income tax in its state of residence; and
  \item[b] a declaration is issued by this other party indicating the amount of difference.
\end{itemize}

In recent years, the Hungarian tax authority has paid more attention to transfer pricing of intercompany loans used for financing acquisitions, and attempts to challenge interest rates applied or even the business rationale of taking out such intercompany loans instead of an equity contribution.

\textsuperscript{10} Section 8(1)(j) of the Act on CIT.
\textsuperscript{11} Point 56 of Section 4 of the Act on CIT.
\textsuperscript{12} Section 7(1)(ny) of the Act on CIT.
\textsuperscript{13} Section 8(1)(j) of the Act on CIT.
\textsuperscript{14} Section 8(5)(b) of the Act on CIT.
Big picture issues in terms of achieving deductibility of interest expense against operating income in Hungary

Corporate restructuring and debt push-down schemes have always been a focus of Hungarian tax authority investigations. However, in recent years, the tax authority has put even more emphasis on auditing debt push-down structures carried out by means of a merger between the acquiring entity and the target company. During these audits, even if the requirements under the thin capitalisation rules were fully met, the tax authority tried to challenge the deductibility of interest expenses by the Hungarian taxpayer by claiming that the transaction was aimed at eroding the Hungarian tax base without having any genuine business purpose.

In the tax authority's practice, interest expenses are usually regarded as deductible for corporate income tax purposes by the legal successor in the case of upstream mergers, while in the case of downstream mergers, the tax authority's practice seems to be more restrictive. In such cases, the tax office usually does not accept the deduction of interest relating to the acquisition loan by the successor, arguing that the debt push-down would result in the acquired company paying the expenses of its own acquisition.

As regards jurisprudence, the Hungarian courts mostly revoke the tax authority's resolutions by rejecting the arguments that the tax office makes against debt push-down structures, ruling in these cases that the tax authority has not been able to prove that the debt push-down structures in question were abusive and had no business substance. Nevertheless, in spite of the favourable case law, it would still be wise to seek a binding ruling from the Ministry for National Economy to confirm the deductibility of the interest expenses.

III SECURITY AND GUARANTEES

General

On 15 March 2014, Act V of 2013 on the Civil Code of Hungary (the Civil Code) entered into force in Hungary; therefore Act IV of 1959 on the Civil Code of Republic of Hungary (the Old Civil Code) was repealed. The Civil Code has introduced numerous novelties in respect of the permitted security structures and guarantees (i.e., security agents; all asset pledges; different types of sureties, etc.) and demolished some instruments that were commonly used on the market in the past (floating charge, etc.). These changes had a great effect on the legal practice and caused some very challenging times in the first year after the introduction of Civil Code. However, the legislative authority deflected most critics and amended the Civil Code in order to reflect the market practice.

As a general principle, provisions set out in the Civil Code in respect of the pledges and mortgages are mandatory rules; as such, rights are handled as in rem rights in the Hungarian legal system, and no deviation is allowed by the contracting parties unless the Civil Code provides an explicit possibility thereto.

Applicability of the Old Civil Code and Civil Code

As some types of security interests under the Old Civil Code have been demolished by the Civil Code, the general principle for the scope of the two is that any security interest established before the entry into force of the Civil Code shall be governed by the Old Civil Code (except where the contracting parties have agreed otherwise).15

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15 Act CLXXVII of 2013 on the issues related to the entry into force of the Civil Code.
Based on the above, before providing any loan to a borrower, the lender shall examine the old pledge register maintained by the Hungarian Chamber of Notaries as still valid and existing quota pledges, floating charges, pledges over movables and pledges identified by description can be registered therein.

**Common security interests**

The Civil Code provides several options for securing claims. In general, to establish a valid security interest, a title instrument and an act of perfection (i.e., an act of publicity) are required.

Title instruments include:
- movable pledge agreement, account pledge agreement, receivables pledge agreement, pledge over IP rights (including trade marks) agreement, quota or share pledge agreement, pledge on assets identified by detailed description (floating charge) and real estate mortgage agreement; and
- guarantee agreement and surety agreement.

Depending on the security interest, the act of perfection may be one or more of the following:
- the registration of the security with the respective registry;
- notification on the creation of the relevant pledge;
- the transfer of the respective collateral to the secured party; or
- notarisation of the agreement.

Regarding a guarantee or surety (personal security interests), the act of perfection is the signing of the security agreement.

**Ranking of pledges and mortgages**

The rank of a real estate mortgage, pledge on movables, account pledge, receivables pledge, pledge over IP rights, pledge on assets identified by detailed description and a quota or share pledge is determined by the time of registration. The applications are considered in the order of their submission.

The ranking can only be modified with the consent of all interested parties, and the new ranking must be registered with the relevant registry.

**Common in rem security interests**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Security</th>
<th>Perfection under the Civil Code</th>
<th>Registration requirement before 15 March 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movables</td>
<td>Pledge</td>
<td>Registration with the collateral registry* or, in case of certain movable assets such as aircraft and ships, IP rights with the separate specialist registry</td>
<td>Registration with the pledge registry or, in case of certain movable assets such as aircraft and ships, IP rights with the separate special registry</td>
</tr>
<tr>
<td>Account</td>
<td>Pledge</td>
<td>Registration with the collateral registry</td>
<td>Registration was not a requirement</td>
</tr>
<tr>
<td>Receivables</td>
<td>Pledge</td>
<td>Registration with the collateral registry</td>
<td>Registration was not a requirement, although the parties could describe the receivables and register them in the pledge registry</td>
</tr>
</tbody>
</table>

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16 Law Decree No. 11 of 1960.
17 Chapter XXI of the Civil Code.
18 Chapter LX and LCI of Civil Code.
<table>
<thead>
<tr>
<th>Asset</th>
<th>Security</th>
<th>Perfection under the Civil Code</th>
<th>Registration requirement before 15 March 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quota</td>
<td>Pledge</td>
<td>Registration with the companies registry</td>
<td>Registration with the companies registry or pledge registry</td>
</tr>
<tr>
<td>Share</td>
<td>Pledge</td>
<td>Registration with the collateral registry</td>
<td>Registration was not a requirement</td>
</tr>
<tr>
<td>Assets identified by detailed description</td>
<td>Pledge</td>
<td>Registration with the collateral registry</td>
<td>This type of pledge did not exist under the Old Civil Code. The floating charge, which was a similar instrument, was registered in the pledge registry</td>
</tr>
<tr>
<td>Real estate</td>
<td>Mortgage</td>
<td>Registration with the land registry</td>
<td>Registration with the land registry</td>
</tr>
</tbody>
</table>

---

**Availability of a floating charge**

Hungarian law recognises a floating charge in the form of a pledge over assets identified by detailed description. The pledge also extends to future assets, without any amendment of the underlying security document. However, those assets cannot be subject to such pledges that are recorded in separate special registries, and in case of which the pledge, charge or mortgage shall also be registered in such separate special registry (e.g., real estates, quotas, IP rights, aircraft, ships, etc.).

**Trust and parallel debt issues**

The creditors may appoint one of themselves or a third party to be their collateral agent. The appointment shall not be included in the pledge agreement, but could be made in a separate document.

The collateral agent must be registered in the relevant registries as security holder. Following registration, only the collateral agent is entitled to enforce the security on behalf of the other creditors.

**Availability of private sale and its main conditions**

<table>
<thead>
<tr>
<th>Security interest</th>
<th>Accessory</th>
<th>Private sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantee</td>
<td>No</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Surety</td>
<td>Yes</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Movables pledge</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Account pledge</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Receivables pledge</td>
<td>Yes</td>
<td>Yes, although not used in practice</td>
</tr>
<tr>
<td>Quota or share pledge</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Pledge on assets identified by detailed description</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Real estate mortgage</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Direct enforceability**

In order to avoid lengthy court procedures, it is recommended to incorporate the security agreements into a notarial deed. As a matter of Hungarian law, a notary public is entitled to issue an enforcement writ upon the request of the beneficiary if the claim to be enforced was incorporated into a notarial deed that shall contain:

a  a commitment for performance and consideration, or a unilateral commitment;
b  the names of the obligee and the obligor;
c  the subject matter, quantity (amount) and legal grounds of the obligation; and
If the aforementioned conditions are met, the enforcement against the debtor can be started without any court procedures.

ii Financial assistance

As of 15 March 2014, the former financial assistance rules are not applicable in respect of limited liability companies and private companies limited by shares.

Regarding public companies, financial assistance is not restricted if the following conditions are met:

a. financial assistance is provided at fair market conditions on an arm’s-length basis;

b. financial assistance is provided from funds that could be distributed to the companies’ shareholders as a dividend; and

c. the company’s shareholders’ meeting, based on the proposal of the board of directors, has given its consent to the contemplated measure through a decision passed with at least a three-quarters majority.

IV PRIORITY OF CLAIMS

i Commencement of liquidation

Regarding the Hungarian legal system, the priority of claims in an insolvency scenario is regulated by the Act XLIX of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (BPA).

As a first step, the insolvency of the debtor shall be declared by the competent court, which shall also order the commencement of the liquidation procedure.

The opening of liquidation proceedings becomes effective as of the date they are published in the Company Gazette, a publicly available online platform. As of this date:

a. companies subject to liquidation proceedings are identified by the use of the affix ‘under liquidation’ after the company name;

b. the court appoints a liquidator, who becomes the sole representative of the debtor company and is responsible for conducting the entire liquidation proceedings;

c. the directors cease to have management power over the debtor company;

d. all assets of the debtor fall within the scope of liquidation assets;

e. any enforcement procedure conducted against any asset of the debtor terminates; and

f. any claim against the debtor may only be satisfied in the framework of the liquidation proceedings.

ii Priority of claims

If the super-priority nature of a loan is only contractually agreed between the parties, it will not be acknowledged by the liquidator. By virtue of law, in a liquidation procedure secured loans have priority over unsecured loans, and in respect of secured loans (if those are secured by the same security asset) the ranking of the security interest is relevant as to the priority of those loans.

19 Section 23/C of Act LIII of 1994 on Judicial Enforcement.
20 Section 28 of the BPA.
If the super-priority loan is secured by the same security asset and at the same rank as another secured loan, the claims of the creditor of the super-priority loan and the creditor of the other secured loan will be satisfied pro rata from the proceeds of the liquidation procedure.

In accordance with the BPA, creditors’ claims are ranked in the following order of priority:

- **a** cost of liquidation (e.g., salaries of employees, costs of sales);
- **b** claims secured by pledges and established before the commencement date of liquidation proceedings;
- **c** alimony claims, life annuity payment claims and compensation benefits to private individuals;
- **d** other claims of private individuals not originating from economic activities (e.g., damages, warranty claims);
- **e** taxes and other public dues as well as public utility charges;
- **f** other claims (e.g., any unsecured claims);
- **g** default interest and late charges, as well as surcharges, penalties and similar debts; and
- **h** claims held by the shareholder or any member of the management.  

However, claims that are secured will enjoy priority in satisfaction irrespective of the order above.

**iii Effectiveness of contractual subordination**

Contractual subordination is not regulated and may not be binding on insolvency officers. However, outside of an insolvency scenario, the parties are entitled to assign or transfer or change their creditor ranks by contractual arrangement. This arrangement might be enforceable, provided that no bankruptcy liquidation or other insolvency procedures will be commenced against the debtor.

**iv Subordination by operation of law**

According to Section 57 of the BPA, shareholder loans are subordinated to other indebtedness in the context of insolvency by operation of law.

**V JURISDICTION**

**i Choice of law**

As a matter of Hungarian law, in respect of contractual aspects, the Rome I Regulation and regarding the non-contractual obligations, the Rome II Regulation shall be applicable for the choice of foreign law by a Hungarian entity. Notwithstanding the above, there are various specific exclusions that fall within the scope of Rome I, for example, contractual obligations arising under bills of exchange, cheques and promissory notes and other negotiable instruments, provided that the obligations under such other negotiable instruments shall not

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21 Section 57 of the BPA.
be subject to Rome I Regulation, but shall be governed by the mandatory national law. The Rome I Regulation also excludes arbitration agreements and agreements on choice of court, and certain company matters. These exclusions should be considered in detail when determining whether Rome I applies to a particular matter. As a result of the applicability of the Rome I Regulation, the particular contractual obligation should not have a link to its governing law.

ii Jurisdiction

As regards the final and binding judgments in civil and commercial matters provided by any court of another EU Member State in respect of a Hungarian entity, the Brussels Ia Regulation\(^24\) applies, and, therefore, these judgments will be enforceable in Hungary.

Regarding final judgments given outside the EU, if there is not a bilateral agreement between Hungary and the country of the court where such judgment was given, the enforceability will not be automatic and the Hungarian courts may decide to re-examine the merits of the case before declaring the enforceability of such judgment.

Hungary acceded to the 1958 New York Convention\(^25\) in 1962.\(^26\) As a consequence thereof, the arbitration awards issued in any other contracting state are enforceable in Hungary subject to certain limited defences.

VI ACQUISITIONS OF PUBLIC COMPANIES

When acquiring a public company, with regard to financing of the acquisition and providing security to the financing, financial assistance rules shall be taken into consideration (see Section III).

Any acquisition of the ownership interest in a public company is subject to a takeover bid (which shall be approved by the NBH in advance) if the acquisition covers more than:

\( a \) 25 per cent of the shares of a public company and neither of the other shareholders holds more than 10 per cent of the shares; or

\( b \) 33 per cent of the shares of a public company.

The takeover bid shall include, among other things, the composition of the consideration of shares – namely, it shall indicate whether the purchase price will be partially financed, although details of such financing shall not be disclosed.

If a potential buyer acquires 75 per cent or more of the ownership interest in a public company, the other shareholders are entitled to sell to such potential buyer their shares at a price determined in the takeover bid.

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VII THE YEAR IN REVIEW

In order to accelerate the economy, the Budapest Stock Exchange (BSE) launched a special platform (Xtend) for small- and medium-sized companies that have the potential to grow into large companies (and, therefore, enter into the main board of the BSE) and could attract more private equity investors. Although Xtend was available from 2017, more companies started to express their interest to enter into Xtend from this year.

VIII OUTLOOK

The Hungarian financing market is picking up pace in terms of financing. Banks have sold most of their non-performing loan portfolios in the past couple of years, and are ready for fresh financing.

The most emerging sectors are the manufacturing and energy sector (in particular the renewable energy sector), in which investors (both financial and professional) have expressed interest.

As a result of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, the BPA was amended by the Act XLIX of 2017.
I  OVERVIEW

Acquisition financing in Ireland typically consists of third party debt (usually by way of senior loans, but sometimes involving mezzanine or second lien debt), together with shareholder debt contributed by the shareholders or sponsors. High-yield bonds have not been a typical feature of acquisition financings in Ireland to date.

Historically dominated by local banks, the Irish lending landscape has changed significantly since the financial crisis. The traditional banking sector is now much smaller, with the remaining banks typically having a reduced risk appetite. This has led to the emergence of a number of direct lenders as significant providers of capital in the Irish market. While the focus of these lenders has predominantly been on the financing of property acquisitions and developments, many of these lenders have also provided financing for leveraged and acquisition financings. Bank finance however remains the most common source of third-party acquisition financing in the Irish market.

While many deals involving an Irish target will be governed by Irish law, larger multi-jurisdictional financings (particularly those involving non-Irish lenders or syndicated facilities) will typically be governed by the laws of another jurisdiction (usually English or New York law).

II  REGULATORY AND TAX MATTERS

Licensing requirements

Generally it is not necessary for a lender to be licensed before lending to a company in Ireland. Lending to a natural person may trigger a licensing requirement, but this is unlikely to be relevant in most leveraged and acquisition financings.

Ireland does not have any particular licensing or eligibility requirements for agents or security trustees and, provided that the agent or security trustee is not also carrying on banking business or other regulated activities in Ireland, there will be no requirement for it to be licensed in Ireland.

1 Catherine Duffy is a partner and Robbie O’Driscoll is a senior associate at A&L Goodbody. The authors would like to thank Richard Marron and Peter Maher for their assistance with the preparation of this chapter.
II Sanctions, anti-corruption and money laundering

While not specific to leveraged and acquisition financings, general anti-corruption and anti-money laundering laws will apply.

Lenders must comply with anti-money laundering and anti-terrorism financing requirements under the Criminal Justice (Money Laundering and Terrorist Offences) Act 2010. The Criminal Justice (Corruption Offences) Act 2018 came into force in 2018. This Act repealed and replaced previous legislation on anti-corruption and bribery (the Prevention of Corruption Acts 1889 to 2010), consolidating Irish law on anti-corruption into a single piece of legislation.

III Reporting requirement

Notwithstanding that there may be no licensing requirement in Ireland, certain lenders will be required to make statistical reports to the CBI under the Credit Reporting Act 2013, which requires lenders to provide specific information in respect of credit exceeding €500 where the borrower is resident in Ireland or the governing law of the loan agreement is Irish.

IV Withholding tax

Like the UK and many other European jurisdictions, Ireland imposes withholding tax on payments of interest, currently at a rate of 20 per cent. Withholding tax is imposed on payments of interest that have an Irish source. Interest will typically have an Irish source if the borrower is Irish resident or an Irish branch or if the loan is secured on Irish real estate.

However, withholding tax can be reduced or eliminated pursuant to a number of exceptions. In particular, in the case of cross-border interest payments, interest will be exempt if it is paid:

a on quoted Eurobonds;

b by a company in the ordinary course of business to a company resident in an EU Member State (other than Ireland) or in a country with which Ireland has entered into a double taxation treaty, provided that either the country generally imposes a tax on the interest receivable by the company or the interest is exempted under the relevant tax treaty. This exemption will not apply where it is paid in connection with a trade or business carried on in Ireland by the payee;

c by a securitisation qualifying company to a person resident in an EU Member State (other than Ireland) or in a country with which Ireland has entered into a double taxation treaty, except where it is paid in connection with a trade or business carried on in Ireland by the payee; and

d on certain wholesale debt instruments for which the term is less than two years.

Ireland has a comprehensive network of double taxation treaties. There are currently 74 countries with which Ireland has signed comprehensive double taxation agreements, of which 73 are currently in effect.

V Deductibility of interest

A deduction is generally available for interest incurred by a company for the purposes of its trading operations. However, in certain circumstances an interest payment made by a company may be reclassified as a distribution for tax purposes, and no tax deduction will be available to the company in that instance.
A deduction is often available for interest incurred on borrowings of a company for the acquisition of shares of a trading company or of a company that holds shares in trading companies, or for lending to such companies, subject to certain conditions being satisfied.

Several conditions are required to be satisfied, including that the borrowing company must beneficially own, directly or indirectly, more than 5 per cent of the relevant company, and must share at least one director with the company or a connected company. Restrictions apply to the recovery of capital by the borrower from the company, and anti-avoidance measures deny the interest relief in certain circumstances.

III SECURITY AND GUARANTEES

i Forms of guarantees and security

Guarantees

Upstream, downstream and cross-stream guarantee and security packages are available and widely used in leveraged and acquisition financings involving Irish companies. Unlike many jurisdictions, guarantees are not typically required to be limited by way of guarantee limitations.

A guarantee must be in writing and signed by the guarantor to be enforceable under Irish law. A guarantee is a contract and so is subject to the general principles of contract law including that there must be consideration unless the guarantee is executed as a deed. Guarantees are often executed as a deed to remove any concerns about the adequacy of the consideration.

Prescribed warnings must be included in a guarantee where the Central Bank of Ireland’s Consumer Protection Code 2012 and the SME Regulations apply. These are unlikely to be relevant in most leveraged and acquisition financings.

Irish law distinguishes between guarantees and indemnities. A guarantee is a secondary obligation, which is dependent on the existence of the primary obligation. An indemnity is an undertaking as an independent obligation to make good a loss and will be enforceable even where the obligation guaranteed is not. Therefore, it is typical in leveraged and acquisition financings for a guarantee to be drafted as a guarantee and indemnity, in which case the distinction can be ignored in practice.

Security

Ireland is a creditor-friendly jurisdiction that allows creditors to obtain comprehensive security at a reasonable cost and, in principle, a creditor can take security over any assets belonging to an Irish company. While a security interest can take multiple forms under Irish law, the typical types of security interest provided in leveraged and acquisition financings are:

charge: This is an agreement between a debtor and a creditor to make an asset available to the creditor to satisfy an underlying debt. This is the most common form of Irish security interest and is typically used in leveraged and acquisition financings for real

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2 Section 2 of the Statute of Frauds (Ireland) 1695.
3 Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015.
4 Certain limited categories of company may be prohibited from creating security over certain types of assets (e.g., regulated entities may be prohibited from creating security over client monies).
estate, shares, intellectual property and bank accounts. A charge may be fixed or floating in nature. A fixed charge is a charge which attaches immediately upon execution of the security document to a specific asset or class of assets. A floating charge does not take effect immediately but will ‘float’ over the asset or assets and remain dormant until a defined event occurs or the creditor gives notice, or both. A purported fixed charge may be recharacterised by a court as a floating charge where the chargor retains significant ability to deal with the asset; however, unlike in England, the Irish courts have tended to look to the contractual terms (and not to the conduct of the parties) in determining whether a purported fixed charge should be recharacterised as a floating charge; and

assignment: This is the transfer of legal or beneficial ownership of an asset by a debtor to a creditor, together with a right for the debtor to have the asset reassigned to it once the underlying debt has been repaid. It is typically used for intangible assets such as debts and other receivables. An assignment can be legal or equitable.

Typically in leveraged and acquisition financings, a debenture (general security agreement) will be provided by an Irish company creating (1) fixed charges and assignments over certain classes of assets and (2) a floating charge over all present and future assets of that company. Irish law permits security to be created over future assets, so security created under a debenture should automatically attach to newly acquired assets of an Irish company. Where security is created over real estate registered with the Property Registration Authority (PRA), an additional security agreement in the form prescribed by the PRA is required.

The concept of a trust is recognised in Ireland, and the use of a security trustee, who will hold security on trust for a changing group of lenders, is well established in the Irish market.

Third-party security is not uncommon, and is generally seen as workable as a matter of Irish law. This would most typically be encountered in relation to security granted by a shareholder or holding company that is not an obligor over shares it holds in or loans it has made to an obligor.

Security over non-Irish assets can be created under an Irish law-governed security document entered into by an Irish company. To what extent this security will be effective will depend on the nature of the secured asset and the laws applicable to the asset in its location. It is prudent to create security over non-Irish assets under a security document governed by the laws of the jurisdiction where those assets are located (particularly where those assets are of material value).

Filings and notifications

Security created over most types of assets by an Irish company must be registered with the Irish Registrar of Companies within 21 days of its creation, otherwise the security will be void against a liquidator and other creditors of the relevant company.\(^5\)

Security created over real estate in Ireland should be registered with the PRA. Depending on the type of asset security is created over, additional filings may be required or desirable. For example, intellectual property may need to be registered in the relevant Irish or European jurisdiction.

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\(^5\) Section 409 of the Companies Act 2014. Exceptions apply for security created over, amongst other things, cash, shares, bonds and debt instruments.
registries. Security over a movable asset such as an aircraft, ship or rolling stock may be required to be registered in the state of registration or, if different, the state where the asset is located or operates from.

Where a fixed charge over book debts or receivables is created by an Irish company, a notice should be filed with the Irish Revenue Commissioners within 21 days of its creation, as failure to do so may impact on the secured creditor’s level of recovery.6

For a security interest created by way of assignment, to create a legal as opposed to equitable security interest, a notice of the assignment must be served on the counterparty.7 There is no time frame within which this notice must be served. It is not necessary to require the counterparty to acknowledge the notice; however, it would be desirable to obtain the counterparty’s acknowledgement where the notice requires the counterparty to carry out or refrain from carrying out certain actions in respect of the secured assets.

ii Limitations on the grant of guarantees and security

Corporate benefit

The Companies Act 2014 (the Companies Act) largely abolished the law of ultra vires (i.e., the rule that a company may not act for a purpose not expressly or impliedly provided for in its memorandum of association).

However, it is a general principle of Irish law that the directors of an Irish company must exercise their powers in what they consider to be the best interests of the company (i.e., there must be a commercial justification or benefit for what the directors do). Where a company enters into a transaction that does not benefit it, the transaction will be void. Irish courts have typically taken a pragmatic approach to corporate benefit, and there is helpful Irish case law that supports the view that, when considering what corporate benefit results from a transaction, consideration may be given to the benefits that accrue to the group of companies of which the company in question is a member and not just to the company itself.

Financial assistance

Section 82 of the Companies Act prohibits any Irish company from giving financial assistance for the purpose of an acquisition of shares in the company or its holding company, unless an exemption applies or unless validated by the ‘summary approval procedure’.

Where the financial assistance is being given by a company that is a private company, it can avail of the ‘summary approval procedure’ (whitewash) which will validate the giving of financial assistance by that company. This involves, among other things, the directors making a declaration that in their opinion the company will be able to pay its debts and liabilities in full as they fall due in the 12 months following the giving of the financial assistance. In addition, certain exemptions are available, including an exemption for refinancings.

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6 Section 1001 of the Taxes Consolidation Act 1997.
7 Under Section 28(6) of the Supreme Court of Judicature (Ireland) Act 1877, the requirements for a legal assignment are: (1) express notice in writing must be given to the debtor; (2) the assignment must be in writing under the hand of the assignor; (3) it must be of the whole of the debt; and (4) it must be absolute and not by way of charge.
Where the company is a public company or is a subsidiary of a public company, it may not avail itself of the whitewash procedure, but other exemptions may apply.  

### iii. Clawbacks and preferences

There are provisions of the Companies Act which allow for transactions entered into by an Irish company to be set aside. These include:

- **a.** improperly transferred assets: Where a company is being wound up, the High Court may, if just and equitable, order the return of assets the subject of a disposal (including by way of security) where such disposition had the effect of perpetrating a fraud on the company, its creditors or its members. There is no time limit within which an improper transfer can be challenged;

- **b.** unfair preference: Any conveyance, mortgage or other act relating to property of a company, which is unable to pay its debts as they become due, within six months of the commencement of a winding-up with a view to giving such creditor (or any surety or guarantor of the debt due to such creditor) a preference over its other creditors, will be invalid. Case law (under the equivalent provision of the previous Companies Act) indicates that a ‘dominant intent’ must be shown on the part of the company to prefer that creditor over other creditors. Furthermore, this Section is only applicable if at the time of the relevant act, the company was already insolvent. Where the conveyance, mortgage, etc. is in favour of a ‘connected person’ (such as a director), the period is extended to two years. If a transaction is held to be an unfair preference, a liquidator or receiver of the company may recover the money paid or property transferred to the creditor, or may have the security set aside; and

- **c.** invalid floating charge: A floating charge created within the 12 months before the commencement of the winding-up of a company will be invalid except to the extent of monies actually advanced or paid, or the actual price or value of goods or services sold or supplied, to the company at the time of or subsequently to the creation of, and in consideration for the charge, or to interest on that amount at the appropriate rate or unless the company was solvent immediately after the creation of the charge. Where the floating charge is created in favour of a ‘connected person’, the 12-month period is extended to two years.

### IV. PRIORITY OF CLAIMS

#### i. Priority of claims on insolvency

Typically the distribution of assets on winding-up of an Irish company would be as follows:

- **a.** fees, costs and expenses of a receiver;

- **b.** payment due to a fixed charge holder;

- **c.** super-preferential creditors (see below for further information);

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8 In the context of an acquisition of an Irish public limited company, it should be possible to reregister the company as a private limited company, following which financial assistance could be given by the company and its Irish subsidiaries (see ‘Acquisitions of Public Companies’ below).

9 Section 443 of the Companies Act.

10 Section 604(2) of the Companies Act.

11 Section 597 of the Companies Act.
Ireland

d amounts certified by an examiner as liabilities of the company incurred during the protection period certified by the examiner as necessary to ensure the survival of the company as a going concern;
e costs, charges and expenses of the liquidation (including the liquidator’s fees, costs and expenses);
f any claim by preferential creditors (generally taxes, rates and employee entitlements);
g payment due to the holder of any floating charge;
h payment to unsecured creditors;
i claims of subordinated creditors; and
j monies due to shareholders by way of return of capital and surplus assets.

Within each category, all claims in that category must receive full payment before any proceeds are distributed to the creditors in the subsequent category.

A holder of a fixed charge will, however, rank behind the costs and expenses of an examiner which have been sanctioned by a court and debts that have ‘super-preferential’ status. In relation to such super-preferential debts, the holder of a fixed charge over book debts may be obliged by the Irish Revenue Commissioners to pay all or part of claims for arrears of income tax and VAT out of the proceeds of its charge. However, if the charge holder has notified the Revenue Commissioners of details of the fixed charge within 21 days of the creation of the charge, then their liability is limited to liabilities incurred by the company after the Revenue has issued a notice of default to the charge holder.

It is possible (and customary) for secured creditors to agree amongst themselves on the order of application of the proceeds of enforcement of their security (see Section IV.ii, which follows this paragraph).

ii Subordination and intercreditor agreements

Contractual subordination is possible in Ireland and intercreditor agreements are commonly used to clarify the relationship between two or more classes of creditors.

Intercreditor agreements for Irish leveraged and acquisition financings tend to be based on the Loan Market Association’s (LMA) standard form. This may be Irish law-governed or, in the context of larger multi-jurisdictional financings, may be governed by the laws of another jurisdiction. In smaller or less complicated transactions, the borrower’s sponsors and the lenders may enter into a simple subordination agreement.

Unlike in England, the Companies Act gives statutory recognition to subordination to bind a liquidator in a winding up. In addition, there is general agreement that customary subordination provisions (such as those found in the LMA’s intercreditor agreement) should be enforceable between the contracting parties in Ireland.

Structural subordination is also possible and may be desirable depending on the particular terms of the transaction.

12 Examinership is a court supervised corporate recovery process available to insolvent (but potentially viable) companies. This provides a moratorium on creditor action for a period of time to enable the examiner appointed to the company to review the company’s affairs, consider its viability and, where possible, formulate proposals for its survival.
13 Section 1001 of the Taxes Consolidation Act 1997.
14 Section 618(2) of the Companies Act 2014.
V JURISDICTION

i Choice of law and jurisdiction

Some but not all loan and intercreditor agreements for leveraged and acquisition financings involving Irish companies are governed by the laws of a foreign jurisdiction (most frequently, English or New York law).

Rules governing the choice of law for EU Member States (such as Ireland) are determined by the Rome I Regulation\(^\text{15}\) in the case of contractual obligations and the Rome II Regulation\(^\text{16}\) in the case of non-contractual obligations. The Rome I Regulation provides that a contract shall be governed by the law chosen by the parties. Therefore, where a contract specifies that the laws of any jurisdiction shall apply, the Irish courts are bound to apply that choice. However, pursuant to Article 3(3) of the Rome I Regulation, where mandatory rights or protections afforded under Irish law do not exist under the laws of the chosen jurisdiction, the Irish court will afford those rights and protections to the relevant parties. The Rome II Regulation provides that non-contractual obligations shall be governed by the laws of the jurisdiction chosen by the parties. This is subject to exceptions that are largely (but not entirely) similar to those set out in the Rome I Regulation.

The submission by an Irish company to the jurisdiction of the courts of another jurisdiction will generally be upheld by the Irish courts.

Irish courts do not automatically give leave to serve process on parties located outside Ireland even where that party has agreed to submit to the jurisdiction of the Irish courts, so it is customary to require foreign obligors to appoint an Irish person as its agent for service of process in Ireland.

ii Enforceability of foreign judgments

In accordance with the Brussels Regulation\(^\text{17}\), a judgment made by the courts of an EU Member State can be enforced in Ireland as if it had been delivered in Ireland, but it may be necessary to obtain an order of the Irish courts in order to do so. Such an order will generally be made; however, the Irish courts can refuse to recognise a foreign judgment in certain situations, including if: (1) it would be manifestly contrary to public policy in Ireland; (2) the defendant was not properly served with the proceedings in sufficient time to arrange for their defence; or (3) the judgment is irreconcilable with a judgment given between the same parties in Ireland.

Judgments granted outside of the EU will generally also be recognised and enforced in Ireland subject to obtaining an order of the Irish courts. In respect of such judgments, in order to be enforceable, such judgment must, amongst other things: (1) be for a definite sum of money; (2) be final and conclusive; and (3) have been given by a court of competent jurisdiction.

Any order of the Irish courts may be expressed in a currency other than euro in respect of the amount due and payable, but the order may be issued out of the Central Office of the Irish High Court expressed in euro by reference to the official rate of exchange prevailing on the date of issue of the order.

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15 Regulation (EC) No. 593/2008 on the law applicable to contractual obligations.
VI ACQUISITIONS OF PUBLIC COMPANIES

The financing of the acquisition of an Irish public company involves additional issues for lenders relative to the acquisition of a private company.

i Regulation and bid structure

Public takeovers in Ireland are regulated by the Irish Takeover Panel Act 1997, which established the Irish Takeover Panel (the Panel), the Irish Takeover Rules (the Takeover Rules) and the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006. The Takeover Rules have the force of law and are administered by the Panel. The Panel has the power to issue rulings and directions which themselves have the force of law. The Takeover Rules apply to public companies incorporated in Ireland whose shares are, or have in the previous five years been, traded on the Irish Stock Exchange (including ESM which is the Irish equivalent to London’s AIM), the London Stock Exchange (including AIM), the New York Stock Exchange and NASDAQ.

There are two principal methods of acquiring control of a public company in Ireland: (1) a general public offer to all shareholders of the target to purchase the shares (a tender offer); or (2) a scheme of arrangement (a scheme). In a tender offer, the bidder makes an offer directly to the shareholders of the target and largely controls the process. A scheme is driven primarily by the target and requires the approval of the Irish High Court. Schemes have tended to be the favoured transaction structure in recent years for recommended offers. Subject to certain changes required as a result of different procedures and time frames applicable to a scheme, most of the Takeover Rules apply in an equivalent manner to a scheme as to a tender offer.

ii Key financing related issues

The key issues that arise under the Takeover Rules on the financing of a public company takeover are as follows:

a certain funds: Where the consideration for an offer is cash or includes a cash element, the offer document must include a cash confirmation, usually from the bidder’s financial adviser, that the bidder has sufficient resources available to satisfy acceptance of the offer in full. Any debt required for the offer must be fully and, save in respect of conditions relating to the closing of the offer, unconditionally committed prior to the bidder making a firm intention to make an offer. As in the UK, if a cash confirmation proves inaccurate, the Takeover Panel can direct the person who made the statement to provide the necessary funds. Therefore, fundable commitment or long-form finance documentation will in practice be required to be in place on or before an offer announcement is made;

b confidentiality: It is a fundamental aspect of the Takeover Rules that absolute secrecy must be maintained until a bid is announced; this applies to both hostile and recommended bids. The Takeover Rules are restrictive in terms of the extension of the ‘circle of knowledge’, and Panel engagement is typically required earlier in the process than in the UK. There is no equivalent to the UK ‘Rule of Six’ (which requires bidders to consult the UK Takeover Panel before more than a total of six parties (including potential lenders) are approached about an offer). In Ireland, the Panel must be consulted when a potential bidder proposes to approach anyone other than individuals in its organisation who ‘need to know’ and its immediate legal and financial advisers; this means that the Panel should be consulted prior to approaching potential lenders;
disclosure of terms: The offer document must contain a description of how the offer is to be financed, the source of the finance and the principal lenders or arrangers. If the payment of interest on, repayment of or security for, any liability (contingent or otherwise) will depend to any significant extent on the business of the target, the arrangements must be described in the offer document;

equality of information: Under the Takeover Rules, information relating to an offer must be made equally available to all shareholders. If it is proposed that debt will be syndicated, it will be necessary to seek a derogation from Rule 20.1 from the Panel to permit any syndicate member who is a shareholder or intending shareholder of the target to participate in the debt syndicate and receive non-public information. In this case, the Panel will require that the lenders establish effective information barriers; and

special deals with favourable conditions: The Takeover Rules restrict a bidder from making arrangements with shareholders of the target with favourable terms, except with the consent of the Panel. This can be an issue in syndication if potential lenders hold (or may hold) shares in the target. Again, the Panel may grant consent where effective information barriers are put in place.

iii Acceptance thresholds and squeeze-out

For a tender offer, the acceptance threshold would typically be set at 80 per cent or 90 per cent as the bidder will need to obtain this level of acceptances in order to rely on the compulsory acquisition (squeeze-out) procedure (the percentage depends on whether the Takeover Directive applies to the target and, if so, a 90 per cent threshold will apply). A bidder will typically reserve the right to reduce its acceptance condition.

As in the UK, lenders may be able to get comfortable with a minimum 75 per cent acceptance condition as this would allow the bidder to ensure that special resolutions are carried. Special resolutions are required, amongst other things, to amend the company’s constitution and approve certain capital restructurings. 75 per cent of acceptances would also allow the bidder to delist the target and convert the target to a private company, which would allow the target and its Irish subsidiaries to give financial assistance in connection with the financing (subject to such companies availing of the summary approval procedure under the Companies Act).

For a scheme, the resolution to approve the scheme must be passed by a majority in number of the target company’s shareholders representing 75 per cent in value of shareholders voting at the meeting (in person or by proxy). Provided that the resolution is passed and the approval of the Irish High Court has been obtained, the scheme is binding on all shareholders with no requirement to effect a squeeze-out.

VII THE YEAR IN REVIEW

After a number of years of significant growth following the financial crisis, recent years have seen a return to a more normalised level of merger and acquisition activity in the Irish market. In 2018, there were over 268 reported M&A transactions with an aggregate value of disclosed deals of about €10 billion. This marked an increase in reported deal volume of 5 per cent as compared to 2017, although deal value fell.
In July 2019, the Irish Central Statistics Office announced that GDP growth for Ireland was 8.2 per cent in 2018, which is the fastest growth rate in Europe and an increase on the 2017 growth rate. The first half of 2019 has seen a very steady level of M&A activity, with 75 deals announced. In addition, there have been four acquisitions of public companies announced so far in 2019, which is significantly more than in recent years. However, there remains a high degree of uncertainty in relation to Brexit and global markets. Therefore, while there is expected to be a significant level of M&A activity in Ireland over the next year, the outlook for M&A activity is more mixed than has been the case in recent years.

As noted above, bank financing has typically been the main source of financing for leveraged and acquisition financings in the Irish market. We would expect to see alternative capital providers continuing to play an increasingly important role in the Irish market in the future.

No Irish legislative initiatives that would have an impact on the leveraged and acquisition financing market are expected in the coming year.
OVERVIEW

In Japan, one of the most typical methods to finance leveraged acquisitions is by senior term loans. Senior term loans often consist of multiple tranches designed with some tranches having an amortisation feature, while others have bullet repayment. Depending on the working capital requirements of the target company, a revolving facility may be provided together with the term loans. The lenders are banks, in most cases, while certain non-bank lenders are active in providing senior term loans in the market. Foreign bank branches licensed as such in Japan (see Section II.i for licensing requirements) are also occasionally providing leveraged finance in Japan. Senior loans are usually secured by security interests over the material assets (including shares in the target company) of the borrower, as well as security interests over the material assets of, and guarantees from, the target company and its material subsidiaries.

Leveraged acquisitions also occasionally utilise mezzanine financing. Mezzanine financing is usually structured as subordinated loans or preferred shares (convertible or non-convertible to common stock), while subordinated corporate bonds are rare. In the recent market where highly leveraged buyouts are often seen, there are sponsors who seek to benefit from higher leverage at the sponsor level of the corporate structure by using mezzanine holdco loans to the parent of the borrower of senior loans.

II REGULATORY AND TAX MATTERS

i Regulatory issues

Licensing

A foreign investor who intends to engage in the money lending business in Japan must be either licensed as a foreign bank branch under the Banking Act of Japan or registered with the relevant authorities under the Money Lending Business Act of Japan (MLBA), unless the money lending in question satisfies an exemption from the MLBA (such as loans to certain affiliates). Both a licensed foreign bank branch under the Banking Act and a registered money lender under the MLBA are required to maintain a place of business in Japan.

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Interest regulation

The interest rate for a loan with the principal amount of more than ¥1 million is capped at 15 per cent per annum (on a simple interest basis) under the Interest Rate Restriction Act of Japan (IRRA). There are arguments on the interpretation of a ‘deemed interest’ concept provided in the IRRA, especially on whether certain fees (such as agent fees, arrangement fees and commitment fees) payable to lenders constitute deemed interest. It is generally interpreted that arrangement fees and agent fees do not constitute deemed interest based on the reason that the arranger and the agent provide equivalent underlying services, but in practice, many lenders tend to cap the overall costs (including interest rate and fees payable) at 15 per cent on a per annum basis. Note that commitment fees for a credit line (such as a revolving facility) are expressly exempt from constituting deemed interest if the borrower satisfies certain requirements stipulated under the Act on Specified Commitment Line Contract of Japan.

While the 15 per cent cap generally does not cause a problem for senior lenders under the current market conditions of low interest rates, the cap could be a more sensitive issue for mezzanine lenders since the interest rate of the mezzanine loan, which often contains PIK interest, is usually calculated on a compounded basis and, when aggregated with upfront fees (on a per annum basis), would be relatively high.

ii Tax issues

Withholding tax

Any interest on a loan payable to a non-Japanese-resident lender is subject to a withholding tax of 20 per cent. This withholding tax may be exempted or reduced to a lower rate pursuant to an applicable tax treaty between Japan and the country in which the lender receiving interest is resident. A loan agreement utilised in the Japanese loan market usually contains a tax gross-up provision to compensate the lender for any loss because of deduction of the withholding tax. In the Japanese leveraged finance market, however, the major issues that are subject to negotiation at the stage of structuring the financing often include whether to permit an offshore lender to be part of the syndication or to be eligible for other permitted assignments under the loan agreement.

Stamp duty

Each original copy of a loan agreement executed in Japan is subject to stamp duty under the Stamp Duty Act of Japan. The amount of stamp duty is determined by the facility amount of the loan agreement, and the maximum amount of stamp duty for a loan agreement is ¥600,000 per original copy. Although nominal, stamp duty in the amount of ¥200 per original copy also arises when executing guarantee agreements in Japan.

2 Under the IRRA, any money other than the principal, however described, received by a lender with regard to a loan shall be deemed to constitute interest, except for expenses in connection with the execution of the contract or performance of the obligations.

3 The typical requirements are, among others, that at the time of entry into the loan agreement, the borrower shall be a joint stock company satisfying any of the following: (1) its stated capital being more than ¥300 million; (2) its net assets (on an unconsolidated basis) being more than ¥1 billion at the end of the latest financial year; and (3) the debt reported on its balance sheet being ¥20 billion or more at the end of the latest financial year. Since an LBO borrower is in most cases a newly established company, the stated capital of more than ¥300 million is typically required at the time of entry into the loan agreement.
III SECURITY AND GUARANTEES

i Guarantee – upstream guarantee
To avoid structural subordination, lenders typically require upstream guarantees from the target company (and its material subsidiaries) to secure the debts of the acquirer owed to the lenders. Under Japanese law, there are no explicit statutory restrictions on providing upstream financial assistance or corporate benefits that would apply to the upstream guarantee. There is no statutory limitation on the amount of a guarantee, and the usual practice is not to limit the guaranteed amount. If, however, there is any minority shareholder of the target, it is commonly understood that the target providing the upstream guarantee may constitute a breach by the directors of the target of their fiduciary duties. A solution commonly adopted in practice is to obtain consent from all minority shareholders for the upstream guarantee. In a transaction where it is difficult to obtain such consent from all minority shareholders (e.g., if the target is a listed company), it is common practice to withhold providing an upstream guarantee until a squeeze-out of minority shareholders is completed.

ii Security interests
Scope of collateral
As collateral in leveraged financing, it is typical for lenders to require (1) a pledge over shares in the borrower and the target (as well as its material subsidiaries); (2) a pledge over receivables of bank accounts held with lenders; and (3) security interests over other material assets that include, among others, intra-group loans, trade receivables, real estate, movable fixed assets and inventory, intellectual property rights, investment securities, insurance receivables and lease deposit receivables. Under Japanese law, there is no concept of a blanket security interest over all assets of a person or entity such as a floating charge. Accordingly, a security interest needs to be created individually over each type of asset. The scope of the security package is in principle ‘all assets’, but the security package is usually negotiated between the parties based on a cost-benefit analysis.

Procedures for creating security interests
For a pledge over shares, other than book-entry shares (such as shares in a listed company), a commonly used method for creating and perfecting the pledge is by delivery of the share certificates to the pledgee. Since this method is only applicable to a company that is classified as a company issuing share certificates under the Companies Act of Japan, if the issuer of the pledged shares is not a company that issues share certificates, lenders often require the issuer to amend its articles of incorporation to become a company that issues share certificates.

For a pledge over or security assignment of monetary claims, the security interest that has been created is perfected by either (1) obtaining the consent of debtors of the pledged or assigned claims, or (2) registration with the competent authorities. Registration of the pledge or security assignment requires a nominal registration tax. It is legally possible to create a security interest over collective receivables, including current and future claims that are identifiable by type of claims, timing (or a period of time) of occurrence and underlying contracts.

For a security transfer of movable assets that has been created, the security transfer is perfected by the transfer of possession or registration with the competent authorities. Registration requires a nominal registration tax. It is also legally possible to create a security interest over collective movable assets that are identifiable by location and type of assets.
For a mortgage over real estate that has been created, the mortgage is perfected by registration with the competent authorities. Registration requires a registration tax in the amount of 0.4 per cent of the registered secured obligations. A provisional registration (for which the registration tax is a nominal amount) is also available for a real estate mortgage in order to ensure the ranking of the security interest, provided that subsequent registration is necessary for perfection.

For a pledge over intellectual property rights, the pledge over registered patent rights or trademarks is created and perfected by registration with the competent authorities. Registration requires a registration tax in the amount of 0.4 per cent of the registered secured obligations.

### Security trust

Under Japanese law, it has been a commonly accepted doctrine that the holder of the security interest must be the same as the creditor of the claims that are secured by the security interest. Accordingly, the practice is for each lender to be a secured party in syndicated loan transactions in Japan since a security agent is not permitted to hold a security interest securing claims owed to these lenders on their behalf. This has been an obstacle to general syndication as an assignment of secured loans requires changes to be made to the security interest already created.

As one possible solution for this inconvenience, an amendment to the Trust Act of Japan was implemented in 2007 introducing the concept of a security trust. This amendment provides for an exception to the above-mentioned doctrine, allowing a trust company licensed under the Trust Business Act of Japan to act as a security trustee that can hold a security interest securing claims owed to lenders. By using the security trust, no individual transfer and perfection procedures for a security interest are necessary when a secured creditor assigns its secured claims because the security holder will continue to be the security trustee despite the change in the holder of the secured claims. In practice, however, security trusts have not been frequently used for syndicated loan transactions in Japan. This situation is presumably, to some extent, because of the lack of conformity of the security trust system with respect to other relevant laws and actual practices, including the registration procedures required for real estate mortgages. Further, the fact that a large part of syndicated loans are ‘club deals’ rather than ‘general syndications’ may also be one of the factors for the less frequent use of security trusts.

### Parallel debt structure

Another possible option is to use a parallel debt structure, whereby a security agent holds a security interest securing a debt owed by the borrower to the security agent that is created in parallel with the actual debts owed by the borrower to the lenders. While we understand that this is a typical structure used in some jurisdictions, especially where a security trustee structure is not available, we do not see this structure used in the Japanese market except for parallel debt structures governed by non-Japanese law (such as English law or New York law) involving a Japanese-law governed security interest.

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4 An agent under the common practice in Japanese syndicated loan transactions has the role of administrative work only, such as delivery of documents and notices, confirmation and communication of majority lenders’ instructions, paying agency work, and other ministerial work relating to the enforcement of lenders’ rights, including in connection with security interests.
One positive move towards utilising the parallel debt structure in Japan is the bill for an amendment of the Civil Code of Japan, which was passed in 2017 and is expected to come into effect in 2020. By this amendment, the Civil Code will explicitly provide for the concept of joint and several claims among multiple creditors created by a contract that has the features of a parallel debt structure. While it has been understood, even under the current Civil Code, that these joint and several claims can be validly created, the feasibility of a parallel debt structure governed by Japanese law has been actively discussed and urged by practitioners. It is anticipated that this amendment to the Civil Code will become an explicit provision that can be relied on to adopt a parallel debt structure in future transactions.

IV PRIORITY OF CLAIMS

i Priority of claims upon insolvency

Senior lenders seek to protect the priority of their loan claims in an insolvency scenario of the borrower, typically by use of (1) security interests (against unsecured creditors generally) and (2) subordination arrangements (against subordinated lenders), as further discussed below.

Secured claims, which have priority over unsecured claims in insolvency proceedings, are handled differently depending on the type of insolvency proceeding taking place. In bankruptcy or civil rehabilitation proceedings, secured creditors may enforce security interests outside of the insolvency proceedings without court approval. In corporate reorganisation proceedings, secured creditors are prohibited from enforcing security interests outside of the court proceedings, but will be given priority over unsecured creditors to the extent of the valuation of the collateral.5

Subordination arrangements are put in place by contract. There are two possible ways for establishing subordination of claims that are acknowledged in practice. The first approach, which can be typically seen in a case where there exists a shareholder loan along with the senior loan, is by the subordinated lender (the shareholder in this case) agreeing in the subordinated loan agreement between the borrower and the subordinated lender that the subordinated lender will not be entitled to equitable distribution among the creditors in insolvency proceedings until all other unsubordinated claims (including, but not limited to, the senior loan) have been repaid in full. The other approach often used when a mezzanine subordinated loan is utilised, is by the mezzanine lender entering into an intercreditor agreement with the senior lender (typically the borrower is also a party to the intercreditor agreement), stipulating that the mezzanine lender will be subordinated to the senior lender in the order of application of any recovered proceeds among creditors. It is commonly understood that the first method of subordination is recognised by the courts in insolvency proceedings, while the second method would not be binding in insolvency proceedings. Accordingly, when using mezzanine subordinated loans, it is common for the intercreditor agreement to further provide for a turnover provision by which the mezzanine lender is required to turn over any recovered proceeds, including distributions received in insolvency proceedings, to the senior lender so that the priority of the senior lender is subsequently achieved contractually.

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5 Unsecured claims are usually treated as general claims in insolvency proceedings which will receive pro rata distribution only after the aforementioned treatment of the secured creditors.
ii Key features of intercreditor agreements

In addition to the turnover provision mentioned above, there are certain other provisions seen in intercreditor agreements which protect the seniority of loans. Intercreditor agreements typically contain (1) provisions for permitted payments to subordinated lenders (the payments for which will be suspended under certain conditions, such as breach of financial covenants), and (2) restrictions on enforcement of certain creditors’ rights by subordinated lenders. In terms of the enforcement of creditors’ rights, inclusion of enforcement standstill provisions is sometimes negotiated, but not yet commonly used in the Japanese market. One of the major provisions that is often negotiated regarding creditors’ rights is the ‘deemed consent’ provision (and the scope of its exceptions) by which the subordinated lender is deemed to have given consent to certain matters requiring consent by the subordinated lender under the relevant agreement between the subordinated lender and the borrower if the senior lender gives consent to these matters.

In recent years, it has become popular to grant drag-along rights to senior lenders that will, upon enforcement of the pledge over shares in the borrower, entitle the senior lenders to require subordinated lenders to mandatorily sell their subordinated loans to whomever the senior lender designates, including the new purchaser of the shares through the enforcement, which can result in facilitating the sale of the shares in the borrower. The consideration that the subordinated lenders will receive for the sale of their loans will be the remainder of the proceeds generated from the enforcement (if any) after full recovery of the senior loans. In this respect, it is also becoming popular to negotiate the inclusion of the concept of certain competitive sales processes upon a distressed sale, which is often seen in LMA-based financing documentation.

V JURISDICTION

Japanese courts generally recognise the validity and enforceability of a choice-of-law provision or jurisdiction that is agreed upon by the parties in a loan agreement. In cross-border transactions where non-Japanese lenders or non-Japanese borrowers are involved, the loan agreement is often governed by a law other than Japanese law (such as English law or New York law). The governing law of security documents is generally determined by the jurisdiction in which the collateral assets are located.

Japanese courts also generally recognise a final and conclusive judgment for monetary claims rendered by a foreign court as valid and enforceable, provided that:

a the foreign court is considered to have valid jurisdiction over the case pursuant to the relevant laws of Japan and treaties;

b the unsuccessful defendant duly received service of process necessary for the commencement of the court proceedings, other than by public notice or notice comparable thereto, and in a manner that is not contrary to the provisions of the relevant bilateral or international conventions concerning service of process or, in the absence of receipt, has appeared before the court;

c the contents and court proceedings of the judgment rendered by the foreign court are not considered to be contrary to the public order or good morals of Japan; and

d there exists reciprocity as to recognition of foreign judgments between the jurisdiction of the relevant foreign court and Japan.
When the prevailing party enforces the foreign judgment, the party must file a lawsuit in a competent court in Japan to obtain a separate judgment that approves the enforcement of the foreign judgment in Japan. In this lawsuit, however, the merits of the case found in the foreign judgment are not re-examined by the Japanese court.

A foreign investor should note that, in relation to item (b) above, the concept of a ‘process agent’, which is commonly used in cross-border transactions, is not recognised as valid service of process in court proceedings in Japan. Accordingly, it is possible that a foreign judgment obtained in a lawsuit where service of process is made via a process agent may be considered not to satisfy the requirement of item (b) above and may, therefore, not be enforced in Japan.

Japan is also a contracting country to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), and, accordingly, a foreign arbitral award can be enforced in Japan in accordance with the provisions of the New York Convention.

VI ACQUISITIONS OF PUBLIC COMPANIES

i Structure of acquisitions of public companies

Outline

A typical structure in Japan for acquisitions of public companies involving acquisition financing is a two-step acquisition comprising a first-step tender offer and a subsequent minority squeeze-out procedure. The acquirer consummates a tender offer to acquire a majority of the issued and outstanding shares in the target company, and thereafter implements a procedure to squeeze-out minority shareholders (as explained in detail below). To ensure that the minority squeeze-out can be successfully concluded, in many cases the floor of the number of shares to be acquired in the tender offer is set at two-thirds of the outstanding shares, allowing a special resolution at a shareholders’ meeting to be passed.

Reform of squeeze-out structure

Historically, procedures for a squeeze-out of minority shareholders had not been explicitly stipulated in the Companies Act of Japan until an amendment to the Companies Act of Japan was enacted in 2015 (the 2015 Amendment). Prior to the 2015 Amendment, practitioners used a complex and time-consuming method for squeezing-out minority shareholders by using ‘callable shares’ combined with a special resolution at a shareholders meeting, which took around three months until the squeeze-out became effective.

The 2015 Amendment offers a more simplified and shortened method for squeezing out minority shareholders compared to the traditional method, namely a cash-out by using a ‘conditional call option’ exercisable by a Special Controlling Shareholder (as defined below). A person or entity that holds 90 per cent or more of the total voting rights in the target company (the Special Controlling Shareholder), either by itself or together with its wholly owned subsidiaries, may exercise a conditional call option and thereby demand other shareholders and holders of share options to sell all of their outstanding shares and share options in the target company (other than any treasury shares) to the Special Controlling Shareholder, subject to approval of the board of directors of the target company. After the 2015 Amendment, an acquirer who has acquired 90 per cent or more of the total voting rights in the target company as a result of the tender offer is granted this straightforward method...
of squeeze-out with just board approval of the target company being required (i.e., without obtaining shareholder approval). This squeeze-out may be concluded within approximately one or two months of the settlement of the tender offer.

Even in cases where the conditional call option is not available (i.e., the shares acquired by the acquirer did not reach 90 per cent), the acquirer who has become a holder of two-thirds or more of the outstanding shares in the target company after the tender offer can now choose an alternative squeeze-out method that has become a recognisable method owing to reforms to the rights of minority shareholders under the 2015 Amendment. This squeeze-out method is conducted by way of consolidating shares by using a ratio that would result in all minority shareholders (which means shareholders other than the acquirer) becoming entitled to receive only fractional shares (which will be subsequently cashed out with court approval).

ii Acquisition financing for tender offers

Under the current regulations applicable to tender offers, a ‘financing out’ condition is not allowed for the acquirer. Given that the acquirer is not permitted to withdraw a tender offer due to its financing failure, the acquirer usually obtains a financing commitment letter from the lender prior to the tender offer launch (or, in some cases, enters into a definitive loan agreement).

While the regulations do not explicitly require strict ‘certain funds’, the competent authorities practically require certainty of the financing. In this regard, under the tender offer regulations, the acquirer is required to disclose a document evidencing the certainty of funds necessary for the settlement of the tender offer via the internet disclosure system of the Financial Services Agency of Japan (the FSA) named the Electronic Disclosure for Investors’ NETwork (EDINET). For an acquisition financing, it is typical to disclose a summary commitment letter issued by the lender to the acquirer. The terms of the letter are usually based on the major terms and conditions agreed in the long-form commitment letter (or, if available, the definitive loan agreement), but it is not practically required to disclose the economic conditions such as margins and fees.

If a fund formed as a partnership is to provide debt or equity financing to the acquirer, the authorities may in practice seek verification regarding the availability of a capital call, including the required funding by limited partners upon this call.

VII THE YEAR IN REVIEW

According to a recent research report, the total number of reported leveraged buyouts and the aggregate amount of leveraged financing in Japan were approximately 47 transactions and ¥240 billion in 2015, 61 transactions and ¥390 billion in 2016, 66 transactions and ¥1,140 billion in 2017 and 63 transactions and ¥980 billion in 2018, respectively. Among them, the total number of reported leveraged buyouts utilising mezzanine financing and the aggregate amount of mezzanine financing in those buyouts were nine transactions and ¥17.5 billion in 2015, eight transactions and ¥14.1 billion in 2016, 13 transactions and ¥48.5 billion in 2017, and 14 transactions and ¥42.7 billion in 2018.

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6 According to guidance issued by the FSA, the FSA requires that a summary of conditions precedent to the financing be described in such letter, and that the acquirer and/or the lender engage in a prior consultation with the competent authorities delegated by the FSA to verify the certainty of the financing.

2017 and 15 transactions and ¥1,192.9 billion in 2018, respectively. After the acquisitions are closed using leveraged finance, refinancing or recapitalisation transactions sometimes take place. These numbers indicate that there is a general increase in the number of leveraged buyouts and growth in deal amounts. When examined closely, the data shows three trends: (1) the number of mega-size deals remains relatively high, which brings up the total deal amount in 2017 and 2018 compared to the preceding years; (2) a disproportionate increase in small-size deals with a decrease in mid-size deals, which accounts for the slight decrease in the total deal amount in 2018 compared to 2017; and (3) a notable increase in both the number and the amount of mezzanine financing, which is attributable to a significantly large deal closed in 2018 utilising mezzanine preferred equity.

**VIII OUTLOOK**

More than a decade of time has passed during which buyouts driven by private equity funds have become popular in Japan, and the market practice of leveraged finance has become well established. In the course of the development of the market, financing needs in leveraged acquisitions are becoming diversified leading to a variety of LBO or leveraged finance structures being utilised, such as mezzanine holdco loans, subscription facilities and recapitalisation by way of a trade sale or dividends.

In recent years, major global private equity funds have been actively investing in Japan with their operations being localised to some extent. Along with their expanded presence, there has been the need for transactions to adopt features of global leveraged finance, such as a ‘certain funds’ concept (especially in bid transactions) that was rarely seen under the traditional banking practice in Japan.

Other notable recent trends of M&A in Japan include the increasing number of carve-out transactions in traditional manufacturing and service industries, and horizontal integration including through roll-up acquisitions. Joint investment by private equity funds and strategic enterprises are also becoming popular. This diversification in acquisition structures impacts financing structures for these acquisitions and is driving acquisition financing to continue being a vibrant and fast growing practice area in Japan.
Chapter 13

NETHERLANDS

Sandy van der Schaaf and Martijn B Koot

I OVERVIEW

The total value and the number of M&A transactions increased in 2018 compared to the previous year. 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. 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 or transferee) to a Dutch borrower is at least €100,000 (or its equivalent in another currency)

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.
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. Furthermore, the Fifth Anti-Money Laundering Directive entered into force on 9 July 2018. This Directive must be transposed into Dutch law, inter alia, by way of an amendment of the Wwft no later than 10 January 2020.

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 UBO register

Under new legislation expected to enter into force in January 2020, all companies, other legal entities and partnerships incorporated or established under Dutch law are required to register their ultimate beneficial owners (UBOs) in a public UBO register. The introduction of an UBO register is part of the implementation of the Fourth and Fifth European Anti-Money Laundering Directives, and the purpose of the register is to combat financial and economic crime, such as money laundering. An ultimate beneficial owner is defined as ‘the natural person who ultimately owns or controls a company or other legal entity’. The UBO register will be part of the Trade Register of the Dutch Chamber of Commerce. It is noted that pursuant to the Fifth European Anti-Money Laundering Directive, all EU Member States must have an UBO register by 10 January 2020.
The Netherlands must also establish an UBO register for trusts and similar legal structures. This UBO register will be introduced through a separate bill that should enter into force no later than 10 March 2020.

### iv 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:

- the person performing the legal act had no legal obligation to do so;
- 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
- 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.

### 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.

### 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 Regulation 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.

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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.

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

The economy in the Netherlands continues to perform well, and the Netherlands is still an attractive jurisdiction for foreign investors. M&A activity in 2019 is expected to increase both in the number of transactions and in total value. Acquisition and leveraged financing is still easy and cheap for buyers to obtain due to the still exceptionally low interest rates. Although in general the outlook for 2019 is positive, there are concerns that the developments in the economy, and the M&A market may be negatively affected in the coming years 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 US tax reform may all affect the economy and the M&A market in the Netherlands in the coming years.
Chapter 14

NORWAY

Markus Nilssen, Magnus Tønseth and Audun Nedrelid

I OVERVIEW

Bank lending remains the main source of debt capital in the Norwegian acquisition financing market, although the introduction of more rigid capital adequacy rules in recent years have limited the growth in bank lending of Norwegian banks during the past few years. Lending is, however, a strictly regulated activity in Norway, meaning that debt funds and other specialist financing providers are not as active in Norway as in many other jurisdictions. Any shortfall in bank lending has primarily been covered by tapping into Norway’s very active high yield bond market where the internationally oriented business areas such as shipping and offshore service suppliers in particular have been able to raise asset-secured debt capital. The high yield bond market has, in addition to traditional corporate financing, to a certain extent also been used as a source for financing of acquisitions, and this is a trend that must be expected to continue in the years to come. For the time being, bank financing is, however, by far the largest source of debt capital financing, also due to the fact that the largest M&A transactions have involved players in the field where the Norwegian and Scandinavian banks have traditionally been substantial players also on an international basis. The largest M&A transactions in value during 2018 were seen within the energy, mining and utilities sector with a total deal value of US$3.7 billion in 2018 according to Mergermarket. There are no immediate signs that this trend will not continue at least into 2020.

II REGULATORY AND TAX MATTERS

Norway currently has strict financial assistance rules in force, which means that a Norwegian company may only grant guarantees or security, or advance funds in connection with an acquisition of the shares in the Norwegian entity or the parent company of such entity, with very strict limitations. The consequence of these limitations is that guarantees and security granted by a Norwegian target company and its subsidiaries will typically only extend to the amount of debt already incurred by Norwegian entities and refinanced as part of the acquisition. There is an exemption for acquisition of single-purpose entities owning real estate, which may nevertheless mortgage their properties in connection with the purchase of the shares in the single-purpose owner (thereby aligning the rules whether the property itself is sold or only the shares in a single-purpose entity with the sole purpose of owning...
the property). The consequence of the above exemption for real property is that acquisition financing involving real property special purpose vehicles can often obtain favourable pricing compared with other acquisitions that do not obtain a similarly strong security package.

It has been suggested that the strict Norwegian financial assistance prohibitions should be softened so that also Norwegian target companies and their subsidiaries should be able to grant guarantees and security in favour of a lender to the purchaser of its shares, and it is expected that a relaxation of these rules will be adopted some time during 2020. However, for the time being there is no clarity as to how the new rules will look, and updated advice should be sought before structuring a financing of a Norwegian target company.

The way the financial assistance prohibition is typically dealt with under the current rules is nevertheless to obtain the usual security package consisting of guarantees and security documents from the target company and its subsidiaries (as obtaining security is not costly in Norway), but adding appropriate limitation language ensuring that the security and the guarantee obligations incurred will only extend to the amount allowed under the law from time to time. In this way, it will be a factual matter how strong the security that is obtained from the target group turns out to be under the specific acquisition financing in question.

As a result of the above financial assistance restrictions as currently in force, lenders must rely to a larger extent on negative pledge clauses and prohibitions against additional financial indebtedness in the target group in order to get the same level of comfort. It is, therefore, our impression that Norwegian acquisition financings have generally had less flexibility for the borrower and its subsidiaries under Norwegian law.

The prohibition that a Norwegian target entity may not advance funds to the benefit of a purchaser of shares in the company will not prohibit the Norwegian target from distributing ordinary dividends to the purchaser.

Lending is a strictly regulated activity in Norway, and a licence or a passport as a bank or other credit institution is needed to conduct lending activities. Norway is not a member of the EU, but through the European Economic Area (EEA) Agreement it is committed to implementing the relevant directives for the finance industry. This means that the free establishment rule applies for EEA banks wishing to provide lending products and services in Norway, and for Norwegian banks wishing to provide similar products and services in the EEA.

The EU’s banking prudential requirements (CRDIV/CRR) will soon be fully implemented in Norway, thus levelling the regulatory playing field between Norwegian banks and foreign banks operating in the Norwegian market through branches or cross-border passports. Further, a legislative proposal for implementation of the EU’s securitisation regulation in Norwegian law was launched in the second quarter of 2019 and will be followed up in the second half of 2019 and into 2020. While these legislative acts will require certain amendments to current Norwegian banking law, we do not expect any radical changes to the current legislative environment for banking activities in Norway.

Over the next few years, the new prudential requirements to be introduced by the EU’s ‘Risk Reduction Package’ (which includes CRD V, CRR 2 and BRRD 2) will continue to have an impact on the activities of Norwegian banks. The BRRD was implemented in Norway with effect from 1 January 2019, and it remains to be seen how the Norwegian FSA will approach the ‘bail-in’ regime under BRRD in relation to Norwegian banks, including in particular the requirement for in-scope banks to hold a sufficient amount of ‘bail-in’ capital. Some instruments may have to be refinanced or renegotiated to qualify, and banks continue to use a substantial part of their profits to strengthen equity.
The upcoming amendments to Norwegian law and the EEA Agreement are expected to result in less ‘gold plating’ and special Norwegian rules for banks and other financial market participants in the future. Norwegian authorities will need to pay increased attention to EEA-relevant financial markets legislation coming out of the EU, and will have less freedom to implement bespoke domestic solutions.

Norwegian borrowers are currently not subject to withholding taxes on payments to lenders. Legislative committees have suggested that Norway should also implement withholding taxes on payments on (inter alia) interest payments; however, no specific suggestion for changing the law has been proposed and it is therefore currently uncertain as to what form such withholding tax on interest on payments would take, if ever even suggested. It should be noted that Norway has a large number of double tax treaties with other jurisdictions where the right to charge withholding taxes to parties in the other jurisdiction is waived by Norway, and as such it is, therefore, likely that even if Norwegian authorities decide to implement withholding taxes in Norway, it will probably take some time before the legal basis for claiming withholding tax becomes effective towards lenders in a large number of jurisdictions.

To prevent tax base erosion and profit shifting out of Norway, there are limitations on the level of interest costs that are allowed for tax deduction in Norway (basically calculated as a formula on taxable EBITDA of the Norwegian entities). Both interest paid to related and non-related lenders (i.e., banks and bondholders) can at the outset be subject to a limitation of tax deduction such that tax deduction of interest costs will be allowed for a Norwegian borrower in a corporate group if the equity ratio of the company or the Norwegian part of the corporate group is at least as high as the equity ratio of the corporate group as a whole (implying that corporate groups with only Norwegian entities will be allowed full tax deduction on interest costs). Note, however, that interest costs paid by a Norwegian borrower to related lenders outside a corporate group can still be subject to limitation of tax deduction, and Norwegian tax advice should be obtained early when setting up a holding structuring for acquiring a Norwegian company from abroad.

The standard LMA FATCA riders are customarily included in loan agreements made under Norwegian law. Norway and the United States have entered into an agreement of automatic exchange of tax-relevant information, thereby limiting the risk of any FATCA liabilities for Norwegian lenders. No Norwegian stamp or documentary taxes are applicable in connection with the establishment, trading or enforcement of a loan under Norwegian law. Perfection or registration costs for security and court fees for enforcement procedures are nominal only and unrelated to the amount of the loan or security in question.

III SECURITY AND GUARANTEES
Granting of guarantees and uptake of security from the target company and its (material) subsidiaries is common in Norwegian acquisition financings. Obtaining security is straightforward in Norway, and there are only nominal registration fees involved in the uptake of security. Norway currently has strict financial assistance rules in force, which means that a Norwegian company may only grant guarantees or security, or advance funds in connection with an acquisition of the shares in the Norwegian entity or the parent company of such entity, within very strict limitations. The consequence of these limitations is that guarantees and security granted by a Norwegian target company and its subsidiaries will typically only extend to the amount of debt already incurred by Norwegian entities and refinanced as part
of the acquisition. There is an exemption for acquisition of single-purpose entities owning real estate, which may nevertheless mortgage their properties in connection with the purchase of the shares in the single-purpose owner (thereby aligning the rules whether the property itself is sold or only the shares in a single-purpose entity with the sole purpose of owning the property). The consequence of the above exemption for real property is that acquisition financing involving real property special purpose vehicles can often obtain favourable pricing compared with other acquisitions that do not obtain a similarly strong security package. It has been suggested that the strict Norwegian financial assistance prohibitions should be softened so that Norwegian target companies and their subsidiaries should also be able to grant guarantees and security in favour of a lender to the purchaser of its shares, and it is expected that a relaxation of these rules will be adopted some time towards the end of 2019 with possible implementation from early 2020. There is for the time being, however, no clarity as to what the new rules will look like, and updated advice should be sought before structuring a financing of a Norwegian target company.

The common security package in acquisition financing consists of a charge over the target shares and its (material) subsidiaries, and such share charges are perfected by way of a notice to the company whose shares have been charged. As Norway has implemented the Financial Collateral Directive (Directive 2002/47/EC) obtaining share security under Norwegian law follows a similar approach to that in the EU, and pre-agreed enforcement procedures are commonly included to ensure swift enforcement of shares either by way of appropriation or a pre-agreed sales process.

Mortgages over real registered asset classes are also easily obtained in Norway by filing simple standard forms with the relevant Norwegian registry. Mortgage over real estate is obtained by filing the mortgage form with the Norwegian Land Registry, mortgages over vessels are obtained by filing the mortgage form with the Norwegian Ship Registry and mortgages over aircraft and certain equipment related to aircraft (in accordance with the Cape Town Convention) are obtained by filing a mortgage form with the Norwegian Civil Aircraft Registry.

Generally under Norwegian law, agreeing to a floating charge over all assets owned by a debtor from time to time is not allowed. Much of the same effect can however be achieved, as floating charges over specific asset classes are allowed. This covers floating charges over a debtor's trade receivables outstanding from time to time, its inventory and its operating assets as well as motor vehicles and construction machines. These floating charges are obtained and perfected by way of filing standard forms with the Norwegian Registry of Movable Property. The floating charge over operating assets also comprises all intellectual property used by an entity in its operating business. It is also possible to take out a separate security over patents (and applications for patents), and this security will particularly cover patents that are not used by the debtor in its own operations, but rather developed for sale or licensing to third parties.

Assignment of specific monetary claims is possible and customary under Norwegian law; however, a Norwegian company can only assign as security any future monetary claim for payment in a specifically mentioned legal relationship, and further with the limitation that the contractual position as such cannot be assigned, only the monetary claim itself. In acquisition financing, assignment over specific monetary claims will typically be granted for potential claims against the vendor under the share purchase agreement, alternatively against the insurance company which has issued the M&A insurance policy. Assignments of monetary claims are perfected by notification to the debtor of the claim.
Charges over bank accounts will be possible in the form of an assignment of the monetary claim against the bank for amounts deposited to the account. These charges are usually obtained in leveraged financing, and will cover the amounts standing to the credit of the operating bank accounts of the target and its (material) subsidiaries from time to time.

The way the financial assistance prohibition is typically dealt with under the current rules is nevertheless to obtain the usual security package over the target and its subsidiaries (as obtaining security is not costly in Norway), but adding appropriate limitation language ensuring that the security and the guarantee obligations incurred will only extend to the amount allowed possible under the law from time to time. In this way, it will be a factual matter how strong the security that is obtained from the target group turns out to be under the specific acquisition financing in question. As a result of the above, financial assistance restrictions as currently in force, lenders must rely to a larger extent on negative pledge clauses and prohibitions against additional financial indebtedness in the target group in order to get the same level of comfort. It is, therefore, our impression that Norwegian acquisition financings have generally had less flexibility for the borrower and its subsidiaries under Norwegian law. We expect a trend towards more flexibility for the bidco and the target group with the expected changes to the financial assistance rules from 2020.

Norwegian law does not recognise the concept of ‘trust’ as known in English law, but it is possible for one entity to hold a security interest on behalf of itself and others. As such, the transaction security in a Norwegian acquisition financing is typically held by a security agent appointed to act on behalf of all of the finance parties. The security agent can be one of the banks party to the transaction or an independent entity. Under Norwegian law, only creditors to a claim may have standing before the courts of Norway. In practice this only has procedural implications, but may entail that all the secured creditors having an interest in the security may participate as joint plaintiffs in a court case involving the security interest in Norway, as the court may decide that the true beneficiaries of the security interest should act as the true party to the case and not through a security agent as its representative.

Generally, under Norwegian law, hardening periods may arise for security granted for debt already incurred. Due to the financial assistance rules that generally limit the value of security and guarantees obtained from the target group, it is nevertheless common to have a clean-up period for 30 to 90 days after the closing of an acquisition in order to bring the security from the target group in place.

The prohibition that a Norwegian target entity may not advance funds to the benefit of a purchaser of shares in the company will in any event not prohibit the Norwegian target company from distributing ordinary dividends to the purchaser.

Norwegian entities (and their boards of directors) will generally have an obligation to act in the best interests of the company, and ensure that there is sufficient corporate benefit when undertaking a transaction. This will as a general rule also apply to the granting of guarantees to related parties. Calculating the actual arm’s-length consideration for a guarantee or security interest under Norwegian law can be complicated, but lenders should make sure that arrangements are in place ensuring that arm’s-length provisions are paid to protect their security position as this will typically be an assumption under the relevant legal opinions granted in favour of the lenders. It is expected that this will be an even more important issue with the new financial assistance rules from 2020.
IV  PRIORITY OF CLAIMS

Pursuant to the Norwegian Mortgage of Act of 1980 No. 2, the bankruptcy estate of any bankrupt party that has encumbered any of its assets as security for obligations owed, has a statutory lien over any such encumbered assets as well as over assets that a third party has encumbered as security for the obligations of the bankrupt party, except for assets that are charged as security in accordance with the Norwegian Financial Collateral Act of 2004 No. 17. The statutory bankruptcy lien, however, will not apply to share charges. Other than for this exception, the statutory lien has priority over all other liens or security interests in the relevant asset, regardless of whether the other liens or security interests have been created voluntarily or involuntarily.

The statutory lien for the bankruptcy estate is limited to 5 per cent of the value of, or sales proceeds for, the encumbered asset. The statutory lien is limited to a maximum amount equal to 700 times the court fee (which at present means a maximum amount of 805,000 kroner) in respect of each mortgage over real estate and for mortgages over other assets registered in registries which are designating property rights by the specific asset, such as for vessels, aircraft and similar. The bankruptcy estate may only apply proceeds from the statutory lien to pay for necessary expenses.

Municipal real estate taxes will also have a preferred standing compared to other liens in bankruptcy, as will salvage claims and certain other customary maritime liens. Ordinary tax claims, such as for income tax or unpaid VAT, will not get a preferred standing in a Norwegian bankruptcy.

Other than the above, no statutory claims will prime a non-voidable security interest. Norwegian law provides detailed regulations as to the order of payments made with proceeds from the unsecured assets of a debtor during the bankruptcy proceedings.

Contractual subordination is recognised and customary under Norwegian law, and may generally take two different forms. The first possibility is to agree to grant a fully subordinated loan (labelled as such), which under Norwegian law is recognised as a separate class of loan that ranks behind all pari passu debt (whether secured or unsecured), but ahead of equity claims from shareholders. In the event of a bankruptcy of the borrower of the subordinated loan, the creditor of a fully subordinated loan will not be able to claim any dividend on the fully subordinated loan unless all the pari passu debt (as well as the prioritised claims, e.g., necessary expenses of the bankruptcy estate) have been paid. The second possibility is to agree to a contractual subordination and turnover in favour of another creditor (typically a bank) of claims of an ordinary pari passu claim against the borrower. In the event of a bankruptcy involving the borrower in such a scenario, the holder of the loan will claim against the borrower in the bankruptcy as normal, but any dividend received from the bankruptcy estate will, in accordance with the subordination and turnover agreement, be turned over to the other party (typically the bank), in accordance with the contractually agreed terms and without involvement of the bankruptcy estate.

Intercreditor agreements regulating security sharing are also customary and its content will vary depending on the structure and type of financing in question. The traditional security structure under Norwegian asset financings has been that of first and second priority security in the same asset, typically with a bank having first priority security in the asset and the junior creditors such as, for example, bondholders having second priority security. The intercreditor arrangements in such a setting would customarily revolve around enforcement rights, standstill periods and cash distribution waterfall, sometimes also with a purchase option for second priority security holders to purchase the first priority collateral position.
V JURISDICTION

Norwegian entities are as a general rule free to enter into contracts governed by foreign law and subject to the jurisdictions of non-Norwegian courts, however, with a caveat that a Norwegian company will usually not be able to circumvent statutory provisions under Norwegian law by way of choosing foreign law as the governing law of the contract.

For contracts governed by the laws of a state that is party to the Lugano Convention of 2007 concerning the recognition and enforcement of judgment in civil cases, a final and conclusive judgment obtained in the courts of the jurisdiction would be enforced by the courts of Norway without re-examination of the merits of the case, all subject to the terms of the Norwegian Dispute Act of 2005 No. 90.

A judgment of a foreign court or tribunal of a state that is not party to the Lugano Convention will also be directly enforceable in Norway under the following circumstances. The judgment is enforceable if it satisfies the requirements for enforceability under any applicable convention for enforcement of foreign judgments to which Norway and the country where the judgment had been passed are parties, and further so that a judgment by a foreign court or tribunal will be recognised and enforced by the courts of Norway if (1) the respective parties thereto have submitted in writing to the jurisdiction of an agreed court or tribunal in respect of the matter in dispute; (2) there is no other mandatory venue for the dispute; (3) the judgment obtained is final and enforceable in and pursuant to the laws of the country where it has been passed; and (4) the acceptance and enforcement of the judgment shall not be in conflict with decency or Norwegian mandatory law or public policy.

Norwegian courts may, in certain circumstances, demand upon application from a defendant, that a plaintiff from a state which is not party to the European Economic Area provides security for costs in connection with the court case.

With regard to liability for damages that arise outside of contract, Norway has not implemented Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II). Norwegian courts would in this event determine that the correct legal venue for resolving legal disputes relating to claims that arise outside of contract will be the jurisdiction that has the closest connection to the dispute based on an overall assessment.

VI ACQUISITIONS OF PUBLIC COMPANIES

The acquisition of companies, Norwegian and foreign (with a few exceptions), listed in Norway is subject to special regulations partly based on Directive 2004/25/EC on takeover bids (the Takeover Directive), which has been adopted by Norway. The Takeover Directive includes:

- notification requirements;
- insider trading and inside information restrictions;
- shareholder disclosure requirements; and
- various requirements for voluntary and mandatory offers.

Shareholding disclosure requirements are triggered when a party acquires the following amounts of share capital or votes in the listed target company or reduces its holdings below these levels, requiring the holder to announce its holdings to the market:

- 5 per cent of share capital or votes;
- 10 per cent of share capital or votes;
Norway

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This includes options and other rights to shares held by a company or its close associates. The reference to voting will mean that share charges may fall within the notification rules if there are agreed procedures or proxies, or both, for voting under the share charges, and legal advice should, therefore, be obtained before charging shares in a listed entity as security in favour of lenders.

A requirement to make a mandatory offer for the shares in the target is triggered when the buyer acquires more than one-third of the voting rights in the target (with repeat triggers at 40 per cent or more and 50 per cent or more of the ownership of the shares or voting rights of the listed company). It is possible to avoid the mandatory offer obligation by selling down below the threshold within four weeks of acquiring the shares that triggered the mandatory offer obligation.

Voluntary and mandatory offers must be notified to, and published by, the Oslo Stock Exchange. An offer document must be prepared in connection with an offer and must be approved by the Oslo Stock Exchange in advance. The offer document must be distributed to all shareholders of the target and made known to all its employees.

A mandatory offer must offer a pure cash alternative, but may also offer alternative forms of consideration. Further, a mandatory offer must be unconditional whereas a voluntary offer can be made conditional (for example, on receipt of 90 per cent acceptance or approval from relevant authorities). The buyer must treat all shareholders equally, although different classes of shares can be treated differently.

Settlement of a mandatory offer must be backed by a bank guarantee from a bank authorised to carry out business in Norway.

It is important to be aware that several industries in Norway are regulated to varying degrees, implying that acquisitions of controlling or large stakes in companies operating in these industries will be subject to approval from the relevant authorities (including listed entities). This includes banks and financial institutions, insurance companies, aquaculture business and companies involved in petroleum exploration and production as well as pipeline transportation.

If the purchaser holds 90 per cent or more of the shares of the target and a corresponding proportion of the votes that can be cast at general meetings of the target, the buyer has the right to acquire minority shareholdings on a compulsory (squeeze-out) basis (and minority shareholders have a right to demand that the bidder makes a compulsory acquisition).

VII THE YEAR IN REVIEW

In July 2018, Nordea announced its acquisition of Gjensidige Bank from Gjensidige Forsikring ASA. Following regulatory approval, the deal was completed in March 2019, and the acquisition will strengthen Nordea’s presence as the second largest bank in the Norwegian market second only to DNB Bank ASA.
VIII OUTLOOK

Norway has an open and internationally oriented economy, heavily influenced by the developments in the oil and offshore sectors. As such, fluctuations in the price of oil and gas will evidently affect activity in the Norwegian economy and thereby also M&A activity (both directly, through acquisitions in the oil and oil services sectors when the oil price is high, and indirectly through a stronger economic sentiment with higher oil prices). Given a steady state in the international financial markets going forward, and stable oil prices, we expect that economic activity in Norway will retain its positive momentum for the next few years.

M&A activity within the oil sector, which has been high over the last couple of years, is expected to continue as a main driving force for high value transactions. The oil service and shipping sectors have been struggling for some time, and there are no immediate signs of an upturn for most segments. We would expect consolidations of smaller players to be part of a long term solution in order for these industries to bring the supply back to balance during the next couple of years.

Further, it is expected that the development of new technological solutions within the banking sector will lead to changes in the way banks operate, not only with regard to payment services but also when it comes to credit decisions and lending. As such, it is expected that fintech and digitalisation in time will increase competition generally in the Norwegian banking sector. New market participants (e.g., Google, Amazon and Facebook) and new techniques (e.g., fintech) for providing financial services will challenge the current market participants and practices. New techniques also bring the need for updated regulations. We expect that fintech will have a more dominant role in the banking sector in 2020 and onwards.

Directly related to the acquisition financing market, new legislation as to whether there will be an easing of the strict financial assistance rules for Norwegian companies must be considered to have a significant impact on the market if and when implemented as expected – probably from some time in 2020.
I OVERVIEW

The Spanish economy is growing modestly, despite the political uncertainty resulting from the elected congresspersons’ inability to reach agreements and form a stable government, the deadlocked situation in Catalonia and the European-wide discussion of Brexit. The Bank of Spain recently lowered its GDP growth predictions for 2019, down from an overly optimistic 2.4 per cent to a more conservative 2 per cent.

In terms of acquisition financing, the Spanish market is doing well. Domestic and international players are making hay while the sun shines; in private equity, for instance, over €5.8 billion was invested in 2018, while 2019 is expected to dwarf that record figure with a remarkable €4 billion in the first semester alone. Additional good news is that investments of over €100 million are also growing, as evidenced by the fact that the first half of 2019 has witnessed as many of those deals as in all of 2018.2

While most of these deals have been financed by international and local banks, lending funds are gaining traction, especially in mid-market deals where the complex environment requires tailor-made solutions that only direct lending can provide in the form of mezzanine or subordinated debt.

In terms of documentation, one can expect the traditional suite of documents found in other jurisdictions. The documentation begins with a commitment letter attaching a term sheet and – in most cases where the borrower (BidCo) is bidding for the target company – providing a certain funds commitment from the lenders (together with the equity commitment letter of the sponsor where the buyer is a single purpose vehicle). The long form facility agreement is not required until a later stage, typically coinciding with the execution of the share purchase agreement. Note that most business acquisitions are primarily structured as share deals due to transfer taxes that may accrue when transferring specific assets, as well as the legal and contractual impediments in connection with the transfer of specific liabilities; for mergers, see the explanation on financial assistance limitations set out below. Following the satisfaction of the conditions precedent set out in both the share purchase agreement and the facility agreement, the funds will be drawn on the closing date, coinciding with the pledge over the shares in the target and the execution of the hedging confirmation letters – either following the ISDA master agreement or the Spanish equivalent CMOF. The use of a closing
protocol, pursuant to which the perfection of the acquisition and of the security interests are mutually linked as a condition precedent to one another, is now a market standard to avoid the chicken-or-egg dilemma affecting these deals.

II REGULATORY AND TAX MATTERS

i Licensing

Lending is a non-regulated activity in Spain, although specific regulatory authorisations and filings are required to act as a financing entity for the general public. Consequently, any domestic or foreign entity can provide funding and charge interest to third parties. However, some features of Spanish law are reserved to Spanish-licensed and EU-passported banks and financial institutions, mostly due to banks’ historic hegemony in connection with the lending market. As a result:

a in terms of the security package, two types of in rem security are not available to regular companies: (1) floating mortgages and non-possessor pledges, which unlike the traditional security interests under Spanish law, allow for a single asset to secure a number of present and future underlying obligations; and (2) financial collateral, regulated by Royal Decree Law 5/2005 implementing Directive 2002/47 EC in Spain, which is especially attractive to creditors as it allows for the appropriation of the collateral and its enforcement is not halted by the opening of insolvency proceedings; and

b in terms of taxation, financial institutions are exempt from paying stamp duty when amending the term or interest of mortgage-backed financing and benefit from other tax benefits as further described below.

ii Sanctions, anti-corruption and money laundering

Spain’s regulations on sanctions, anti-corruption and money laundering mostly stem from the European harmonised rules and guidelines. However, it is worth noting that any company executing a public document must evidence the identity and details of its ultimate beneficial owner or controlling person to the notary public. The definition contained in Spanish law defines the ultimate beneficial owner or controlling person as a natural person who directly or indirectly holds or controls more than 25 per cent of the capital or voting rights of the company, or directly or indirectly exercises control over it by other means (including in their capacity as directors of the company). The only companies exempted from identifying controlling persons are listed companies, financial institutions and public entities in all cases based or licensed in the EU or equivalent countries, and any subsidiaries and branches thereof.

iii General tax considerations

Lending is subject to, but exempt from, value added tax. Interest and other income received by Spanish lenders are subject to Spanish corporate income tax, and should, therefore, be included in their tax base upon its accrual (a concept based on the income disclosed on the financial statements of the Spanish lenders, with some adjustments established in the corporate income tax regulation).

According to Spanish law, stamp duty is triggered when a public deed or a notarial minute is granted, with an economic valuable content and which is eligible for registration with a public registry and not subject to transfer tax, capital duty or inheritance and donations tax. Thus, mortgages over real estate located in Spain trigger the accrual of stamp duty, which
is a percentage – between 0.25 per cent and 3 per cent depending on the Spanish region where the relevant asset is located – of the total amount (principal, interest, default interest, etc.) secured by the mortgage – typically ranging between 120 and 140 per cent of the principal amount of the facility.

Stamp duty will also accrue when assigning mortgage-backed loans to the extent the assignment is recorded within the relevant land registry. It is not uncommon, however, that the parties decide to formalise the assignment through a Spanish notarial document that is not eligible for registration with the land registry or to structure the assignment by way of a sub-participation.

Furthermore, some guarantees granted by persons who are not engaged in business activities (e.g. individuals) may trigger Spanish transfer tax, and specific promissory notes and checks may also be subject to stamp duty. The rates vary throughout the Spanish regions, but are set around 1 per cent of the secured amount with respect to transfer tax and 0.3 per cent of the document’s face value with respect to stamp duty.

iv Tax deductibility
Subject to the limitations described below (none of which are applicable to financial institutions), interest is a deductible expense for corporate income tax purposes, as is any transaction cost or fee. However, expenses arising from intercompany loans will not be deductible if they fall within either of two categories: (1) profit participating loans (regulated in Spanish Royal Decree Law 7/1996); or (2) loans directed at financing the acquisition of shares held by another group company or to increase another group company’s share capital or equity – unless, in both cases described in item (2), valid economic reasons are evidenced.

As a general principle, companies may only deduct their net interest (the excess of financial expenses over financial income) up to an amount equivalent to the higher of: (1) €1 million; or (2) 30 per cent of their operating profit (a concept defined in Spanish law similar to EBIDTA). Any excess may be carried forward without a time limit to the extent the thresholds are respected.

With respect to acquisition financing in particular, the tax-deductibility of interest paid in consideration of a debt incurred in order to acquire the shares of the target is limited to 30 per cent of BidCo’s EBIDTA (as defined in Spanish Law), disregarding for this purpose the EBIDTA corresponding to any company that merges with BidCo or joins the same tax group as BidCo within the four-year period following the acquisition. This limit does not apply if at least 30 per cent of the acquisition is financed with equity and the debt incurred is reduced every year by at least the proportional part required to reduce the debt to 30 per cent of the acquisition price in eight years, until this level of debt is reached.

v Withholding tax
Withholding tax at a rate of 19 per cent is levied on any interest paid (although refundable to Spanish-resident lenders from their own corporation tax), to the extent none of the following exemptions apply: (1) interest received by specific entities exempt from paying corporate income tax (mainly public authorities); (2) interest on principal received by banks and specific financial institutions; (3) interest on principal received by securitisation funds; and (4) any interest received from Spanish lenders belonging to their borrower’s tax consolidation group.

Non-Spanish resident lenders that are the beneficial owners of the Spanish-sourced interest may benefit from an exemption of withholding tax in Spain provided that they fall within one of the following categories: (1) Spanish branches of foreign credit entities,
duly registered before the Bank of Spain; (2) entities resident in an EU Member State not acting through a country or territory considered a tax haven under Spanish law or through a permanent establishment located outside the EU; or (3) entities resident in a jurisdiction that has entered into a double tax treaty with Spain that contains an exemption for interest payments and that are fully entitled to benefit from the treaty.

Note that, for these purposes, EU residents and treaty lenders should: (1) not carry on a business in Spain through a permanent establishment with which that lender is effectively connected; and (2) obtain a valid and in-force certificate of tax residency in their specific country of residence. The certificate should be provided to the borrower in a timely manner before any payment of interest is due or paid (whichever occurs first).

Finally, it is worth reminding that beneficial owner status must be carefully reviewed in light of the European Union Court of Justice decisions of 26 February 2019 (in cases C-115/16, C-118/16, C-119/16 and C-299/16, N Luxembourg I et al, and cases C-116/16 and C-117/16, T Danmark et al).

vi FATCA
Spanish market practice follows the standard no-FATCA-gross-up provisions published by the Loan Market Association, and borrowers do not make additional payments on account of FATCA withholdings as a general rule.

III SECURITY AND GUARANTEES
i Standard security package
Under Spanish law, a security interest can only secure one main obligation (principal and interest, costs, etc.). Therefore, each secured obligation will require its own security interest, with the exception of floating mortgages and non-possessory pledges described above. Additionally, although Spanish law allows multiple mortgages to be created over the same collateral, it is silent on pledges; nevertheless, this is now market practice and is generally accepted by legal scholars.

Although lenders usually require a security package that covers all the assets and rights (and, therefore, all potential sources of income) of the target and over BidCo to the extent structured this way, there is no way of covering all the assets of a company since the security interest to be created varies depending on the nature of each asset under Spanish law. Alternatively, if the relevant legal requirements are met, a chattel mortgage could be created over the business, which for these purposes includes the business premises and its facilities, commercial signs and lease and transfer rights.

The security package in a Spanish acquisition financing typically consists of a pledge over the shares of the target and over BidCo, to the extent structured this way, a pledge over the bank accounts of BidCo and a pledge over the credit rights arising from the share purchase agreement. Note that depending on whether the company whose shares are being pledged is a private limited liability company or a public limited liability company – and, in the latter case, depending on whether or not the company is a listed company – perfection requirements will vary.

Both the pledge over shares of a public limited liability company and the pledge over the bank accounts could be structured as financial collateral pursuant to Royal Decree-Law 5/2005, to the extent the creditors comply with the subjective requirements set out above.
The most obvious advantage of applying the financial collateral regulations is the lenders’ right to acquire the ownership over the encumbered asset, as opposed to the traditional Spanish-law principle of initiating an auction sale process.

Note that the region of Catalonia has special legislation regarding, among other matters, the creation of pledges (the most significant disadvantage being that the pledged collateral cannot be repledged except in favour of the initial pledgees and provided that the secured liability is distributed among the secured obligations), and will be applicable when, for instance, the corporate headquarters of the limited liability company is located in Catalonia, the share titles of the public limited liability company are deposited or registered in Catalonia, or the bank accounts are held in branches located in Catalonia.

To avoid the stamp duty cost described above, lenders may allow the borrower to grant promissory mortgages – in lieu of actual mortgages. These promissory mortgages do not accrue stamp duty but are not in rem security: the grantor of the promissory mortgage undertakes to create the mortgage if and when the agreed trigger occurs (at which moment the stamp duty will accrue).

Alongside the security package, the chargors are required to grant irrevocable powers of attorney in favour of the security agent in order to allow the latter to carry out specific actions aimed at perfecting, preserving and enforcing the charge. The powers of attorney must be documented in a Spanish public deed and contain specific wording to rebut any potential future challenges by the grantor regarding their irrevocable nature.

### ii Security agent

Spain has neither signed nor ratified The Hague Convention of 1 July 1985. As a result, the concept of security agent or security trustee does not exist in Spanish law, and the idea itself is of dubious compatibility with certain core principles of Spain’s legal system.

Under Spanish law, security interests are construed as ancillary to the underlying obligation; thus, a security interest governed by Spanish law must be granted in favour of the creditor itself. Parallel debt structures are not regulated under Spanish law and are not commonly used for implementing Spanish security interests securing a facility governed by foreign law given that Spanish law requires that contracts and obligations be based on a valid, legitimate basis in order to be valid and enforceable.

Splitting the legal title and equitable right is neither contemplated under Spanish law nor binding upon third parties. Thus, a contractual scheme implementing the same outcome that a trust would have would not be enforceable against third parties, including in cases in which the trustee were to breach its obligations.

If a Spanish company were to act as a trustee, the assets held in trust would not be considered as a segregated, separate estate and immune from other creditors of the security trustee.

Notwithstanding all of the above, it is common in Spanish syndicated lending to appoint a security agent that is responsible for day-to-day issues and, if and when required, initiates the enforcement proceedings; however, in order for the security agent to appear on behalf of all secured creditors and accept the creation of, or enforce, the security interests, the security agent will need to evidence that it has been validly empowered by each of the secured creditors to carry out the corresponding task. In order for the powers of attorney to be valid in Spain, they must be notarised in the grantor’s jurisdiction of incorporation and bear the apostille of The Hague Convention of 5 October 1961 (or be legalised, in cases where the grantor’s jurisdiction of incorporation is not a party to the Convention).
iii Financial assistance

Spain has yet to implement the provisions of Directive 2006/68/EC loosening the restrictions on financial assistance. This means that Spanish financial assistance rules are stricter than the norm in the European Union. Spanish companies are prohibited from advancing funds, making loans, providing guarantees, security or any kind of financial assistance to a third party for the acquisition of its shares or shares of its controlling company and – for private limited liability companies – any other company of its group. The norm does not establish a time frame limitation, thus impacting any refinancing of acquisition financing. Transactions in breach of the prohibition would be declared null and void and lead to fines being imposed on the company’s directors (for up to the nominal value of the shares acquired as a result of the breach). The two safe harbours – stock option plans for employees and transactions executed by credit institutions in their ordinary course of business – are not applicable to the majority of transactions, and the traditional solution of conducting a forward merger with the BidCo has been limited by Spanish merger rules if the acquisition financing was granted in the three years preceding the merger. Notwithstanding the above, financial-assistance rules do not establish any specific limitations on distribution of dividends or on share capital reductions. Those corporate transactions will not generally be regarded as prohibited under financial-assistance rules and will be permitted insofar as the corporate benefit test is passed.

iv Corporate benefit

Directors of a Spanish company must perform their duties loyally and diligently in accordance with applicable law and the company’s articles of association, and give preference to the interests of the company over those of any other person, including the interests of its parent company or group. Notwithstanding this general principle of law, numerous legal scholars and some case law have vindicated the corporate benefit in guaranteeing indebtedness of group companies that benefits the group as a whole. In any case, directors should analyse corporate benefit on a case-by-case basis considering, among other circumstances, the structure of the group, the nature and amount of the guarantees given, the purposes of the financing and the direct and indirect compensation received as consideration for the security or guarantee. Downstream guarantees are easier to justify in terms of the parent’s corporate benefit as the subsidiaries’ financing is likely to impact the future distributions to the parent. Upstream or cross-stream guarantees may, in turn, prove more challenging as the guarantor’s corporate benefit is not always tangible. If a court determines that the corporate benefit was breached, the directors would be liable for damage caused by the breach, and their decision would be declared void even if the declaration would not prejudice good-faith third parties.

IV PRIORITY OF CLAIMS

i Priority of claims

Spanish insolvency law differentiates between creditors against the estate (consisting of expenses incurred in the course of the insolvency proceedings or necessary for the continuity of the business), which are paid at maturity and before the repayment of the unsecured creditors, and insolvency creditors, which are those whose credit rights arose before the opening of the insolvency proceedings.

Insolvency creditors are in turn divided among: (1) secured creditors (who are to be repaid with the proceeds of the sale of the encumbered asset); (2) privileged creditors, an exhaustive list consisting of, inter alia, employees and public authorities – including tax and
Social Security – (who are to be repaid with any excess proceeds following repayment of credits against the estate); (3) ordinary creditors, a concept that captures any creditors not belonging to any other category (and who are repaid pari passu with any excess proceeds after repayment of the privileged creditors); and (4) subordinated claims.

Subordinated creditors are those holding any of the following claims (and in the following order): (1) claims that were reported late to the insolvency receivership; (2) contractually subordinated claims; (3) claims for interest of any kind; (4) claims for fines; (5) claims held by creditors holding a special connection with the insolvent company (see explanation for equitable subordination below); (6) claims held by creditors found to have acted in bad faith in the context of claw-back proceedings; and (7) claims held by creditors found to be acting consistently to the detriment of the insolvency proceedings.

ii Enforcement of security with an insolvent chargor

Secured creditors will be impacted by the chargor’s insolvency differently, depending on whether or not the security is financial collateral subject to Royal Decree-Law 5/2005. Financial collateral is not limited, restricted or in any way affected by the initiation of insolvency proceedings, and thus may be enforced upon acceleration of the facility.

Enforcement of security that does not qualify as financial collateral but that is deemed necessary for the continuity of the insolvent company’s business (which generally encompasses all – or substantially all – of its assets) will be paralysed upon the opening of the insolvency proceedings until the earlier of: (1) the approval of a creditors composition agreement (and provided that the secured lender has not voted in favour of it, in which case it will be bound by its terms); and (2) one year since the opening of the insolvency proceedings, provided that the insolvency court has not opened the liquidation phase.

iii Equitable subordination

Spanish insolvency law imposes equitable subordination upon creditors of an insolvent company that either: (1) hold, directly or indirectly, 5 per cent or more of the borrower’s share capital, if the borrower is listed, or 10 per cent or more in the case of a non-listed borrower; or (2) were appointed or de facto directors, liquidators or general representatives of the insolvent company in the two years immediately preceding the opening of the insolvency proceedings. Assignees acquiring any such claims in the two years immediately preceding the opening of the insolvency proceedings will be affected by equitable subordination, unless proven otherwise.

In contrast, creditors meeting either of the two requirements as a result of debt-for-equity transactions contemplated in a court-sanctioned restructuring agreement will not be deemed subordinated with respect to any other claim they may hold.

iii Claw-back

Spanish Insolvency Law allows the insolvency court (upon the insolvency receiver’s or, alternatively, any creditor of the insolvent company) to rescind any action taken or agreement reached by the insolvent company in the two years immediately preceding the opening of the insolvency proceedings, provided that the court concludes that the action or agreement is detrimental to the insolvency estate, without requiring any fraud or bad faith from either the insolvent company or its counterparty.

The law provides for some scenarios where the detriment cannot be rebutted (such as: (1) actions or agreements made or executed by the insolvent company for no consideration; and (2) prepayments of unsecured indebtedness maturing after the opening of the insolvency
proceedings) and determines that actions taken in the ordinary course of business and under normal circumstances cannot be rescinded. However, what constitutes ‘ordinary course of business’ and, by extension, the detrimental nature of an action or agreement, is by and large left for the insolvency court’s interpretation on a case-by-case basis. In some cases, the burden of proving the inexistence of a detriment is transferred to the counterparty of the insolvent company: (1) sales of assets to persons subject to the equitable subordination; (2) creation of rights \textit{in rem} to secure preexisting indebtedness or a refinancing thereof; and (3) prepayments of secured indebtedness maturing after the opening of the insolvency proceedings.

In principle, when an action or agreement was at the time undertaken or executed the most feasible alternative to prevent further deterioration to the insolvency estate, the action should not be considered detrimental to the insolvency estate and thus would not be rescinded. By the same token, actions and transactions that adversely affect the \textit{par condition creditorum} (the right of all creditors to be treated equally) may be considered detrimental (for example, actions, agreements or transactions that, while benefiting some creditors, reduce the likelihood of others being paid) even if the debtor’s assets are not reduced as a consequence of those actions.

V JURISDICTION

Spain is bound by Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). As a result, the choice of a law other than Spanish law is valid and would be recognised by Spanish courts to the extent that it does not infringe Spanish public policy or mandatory provisions of Spanish law.

Despite the above, the choice of English law (or any other foreign law) is rare in purely Spanish transactions and increasingly uncommon in larger transactions following the approval of pre-insolvency and court restructuring regulations.

If, however, the agreement is subject to a law other than Spanish law and a Spanish company is an obligor, input will be required from a local lawyer with respect to, inter alia: (1) the analysis of the corporate benefit and financial assistance limitations described above; (2) the structure of the security to be created by the Spanish obligor; (3) the corporate approvals required by the Spanish obligor; (4) the insolvency-related issues to be taken into account; and (5) the access to expedite enforcement proceedings vis-à-vis the Spanish obligor.

With respect to jurisdiction, the choice of Spanish courts is the norm to the extent the principal borrower is a Spanish company. Arbitration is nearly unheard of.

VI ACQUISITIONS OF PUBLIC COMPANIES

Acquisitions of Spanish listed companies are typically effected through takeover bids with cash consideration, which may be voluntary or mandatory if certain requirements are met.

i Mandatory bids

If a transaction has the effect of giving ‘control’ over a Spanish listed company, the buyer will be forced to launch a mandatory, unconditional bid for all of the shares in the target and for an ‘equitable price’, within one month of acquiring such control. For these purposes, ‘control’ means direct or indirect acquisition of at least 30 per cent of the voting rights of the target or, absent this percentage, being entitled to appoint, within 24 months of acquisition, a number
of directors that, combined with the existing directors already appointed by the same buyer, constitute a majority of the board. Control may reside in a single entity or in various acting in concert.

ii Voluntary bids

Insofar as the requirements to launch a mandatory bid are not met, the buyer may freely decide the number of shares, the purchase price and the conditions precedent – including minimum level of acceptance – of the offer.

iii Financing takeover bids

Bidders launching a takeover bid over a Spanish listed company must evidence to the regulator – the National Securities Market Commission – that they have the necessary funding to finance the cash payments contemplated in the bid, and either make a cash deposit at a credit institution or – a more common solution – provide a bank guarantee (which is issued in the context of the facilities agreement used to finance the acquisition itself).

Certain-funds clauses are typical in these structures, even though there is no legal requirement to publicly disclose the documentation. Instead, only information regarding the guarantees posted (and the guarantor’s details), the economic terms of the financing, the creditors’ details and the impact on the target’s balance sheet, if any (including a detailed explanation if the target’s cash flow is to serve the debt).

iv Squeeze-out

Spanish law grants bidders a squeeze-out right, and a sell-out right to minority shareholders, provided that: (1) the bid was launched for all of the target’s voting rights; (2) at least 90 per cent of the bid’s addressees accepted the offer; and (3) the bidder’s resulting stake in the target is at least 90 per cent of the voting rights. Both rights will force the transfer of the minority stake within three months and at the same price offered in the bid.

VII THE YEAR IN REVIEW

Further integration and measures to reduce costs and improve capitalisation are expected in the Spanish banking sector. Spanish institutions are currently implementing concentration processes and are still very active in selling loan portfolios and distressed real estate assets, which are now conceived as large-scale deals.

Large restructuring transactions (some of which are the continuation of previous restructuring processes) have continued to play an important role, as significant deals closed during 2019 remain ongoing.

Leveraged loans have increased finance M&A activity. Furthermore, a large number of Spanish companies have refinanced their debt or issued bonds to improve its terms. Finally, a notable number of medium-sized companies have either entered alternative debt capital markets for the first time or continued the trend of issuing securities to reduce their dependency on banks.

Project finance is also due to increase, particularly as new policies that boost public spending on infrastructure and renewable energy projects now have access to more competitive pricings by means of executing PPAs.
Within this context, the Spanish General Codifying Commission is currently drafting a consolidated Spanish Insolvency Law that will likely introduce certain amendments to the insolvency framework to match new preventive-restructuring tools (including majorities, cross-class cram down and allowing the sale of the entire business of the insolvent debtor as a going concern), as well as the rules applicable to the receivers.

Finally, the Real Estate Credit Agreements Law was enacted on 16 March 2019, which partially transposes Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No. 1093/2010. The main purposes of the Real Estate Credit Agreements Law are to: (1) increase legal security; (2) eliminate any lack of transparency regarding real estate credits; and (3) reduce the litigiousness associated with specific unfair contractual clauses.

VIII OUTLOOK

Domestic and international banks operating in Spain continue to be exposed to demanding regulations, low interest rates and high competition due to the existence of alternative sources of financing, which are developing into real competitors to traditional bank lending.

Traditional lenders must, therefore, pay close attention to the potential effects these challenges pose for their businesses and activities and decide which alternatives are best to address them.

Ultimately, the way lenders tackle the current challenges and adapt to new regulatory requirements will determine acquisition-finance volumes for the upcoming years.
I  OVERVIEW

Bank financing is still the most common source of acquisition finance on the Swedish market, although the bond market is currently an attractive alternative for refinancings. The Swedish leveraged finance market in general has long been virtually dominated by bank finance (sometimes with additional mezzanine financing on top), but direct lending is increasing, in particular from debt funds. The big Nordic banks are still the biggest lenders; however, the interest of the other European banks continues to increase. In many ways, the market is now very similar to the way the market was prior to the last banking crisis; the market is back to a 'cove-lite/cove-loose' market, but the lenders have during the most recent months become slightly more careful in negotiations.

The Swedish corporate bond market has, at the same time as it has grown, become increasingly harmonised. For instance, independent agent functions are now well established, although the automatic right for the agent to represent the bond holders before court has not been confirmed in any court cases. In 2013, the Swedish Securities Dealers Association published for the first time a draft of harmonised terms and conditions for high-yield corporate bonds. The draft terms and conditions have been further developed and found general acceptance on the Swedish market as a starting point for non-commercial terms and conditions for Swedish corporate bonds.

Note that this chapter describes, unless otherwise stated, features with application for unregulated legal entities, primarily limited liability companies, and that other rules may apply for regulated entities, other types of legal entities or natural persons.

II  REGULATORY AND TAX MATTERS

1  Regulatory matters

Banking and financing services provided in Sweden are regulated by, inter alia, the Banking and Financing Business Act.\(^2\) Banks having a licence in one Member State of the EU can passport the licence they have in their home country into Sweden and register for cross-border services or open a Swedish branch. However, a foreign company does not need a licence or to be incorporated locally solely to lend to Swedish entities (unless combined with accepting deposits from the public) or to obtain security over assets located in Sweden, including acting as a security agent on behalf of other lenders.

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1 Paula Röttorp is a partner and Carolina Wahlby is a specialist partner at Hannes Snellman Attorneys Ltd.
2 2004:297.
Special licensing requirements apply to consumer lending, but this chapter will not describe rules applicable to consumer lending or consumer legislation.

Listed corporate bonds are subject to listing requirements (however, it is not a legal requirement to list the bonds) of the Swedish Financial Supervisory Authority and the regulated market where they are listed (if applicable), for example, the rulebook for issuers from Nasdaq Stockholm as applicable on its regulated market, and, inter alia, requirements regarding the prospectus for listing and rules regarding market abuse and disclosure obligations.

Since Sweden is a Member State of the EU, banks, investment firms and funds are subject to a growing number of regulations and among the most obvious newer regulations are the amendments to the CRR Regulation and PSD2. As has been the case for other European banks, this has led to increased efforts among domestic banks to keep up with the compliance work required by such rules and regulations both from a legal and a financial or structural perspective. This may increase the competitiveness (at least to some extent) and business opportunities for less regulated sources of funding, such as alternative debt providers.

ii Tax

In connection with leveraged financing in general, profit repatriation and servicing of debt by the target group are arguably the two central tax considerations together with the rules concerning tax consolidation. These must be analysed in detail in each specific case.

Profit repatriation and servicing of debt may be done through dividend distributions. A dividend from a Swedish subsidiary is tax-exempt to the extent covered by the participation exemption. These rules exempt gains made on a sale of ‘business-related shares’ from Swedish capital gains tax (a corresponding loss is not deductible), and a dividend on such a shareholding would not be taxable. Dividends from foreign jurisdictions are generally tax-exempt, provided that the subsidiary is the equivalent of a Swedish limited liability company and covered by the participation exemption rules. This is a key concern to analyse with local counsel in other jurisdictions when structuring an acquisition.

Profit repatriation and servicing of debt may also be done through interest payments on intragroup loans. Interest payments received constitute taxable income. Interest payments made by Swedish companies are tax-deductible provided the interest level is set at arm’s-length and the debt is not contrary to the interest deduction limitation rules. Due to recent changes in pertinent legislation tax, deductions for negative net interest is only allowed up to an amount corresponding to the higher of (1) correlative to 30 per cent of the company’s EBITDA, or (2) of 5 million kronor for the group. Companies are free to choose between these two alternatives, but as other factors play in, it is advisable to consult with tax advisers before making the decision.

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**Swedish tax consolidation**

The Swedish tax consolidation system provides for group contributions between group companies as a way of consolidating for tax purpose. The criteria are, inter alia, that ownership exceeds 90 per cent of the share capital at each step of the procedure. The group contributions are taxable in the receiving company and tax-deductible in the paying company, meaning that profits can be shifted to a loss-making company in the same group and offset against the tax losses. Group contributions require sufficient distributable reserves in the providing company since group contributions are considered to be dividends for company law purposes. In profitable companies with no negative equity, this should not be a problem as long as the amount contributed does not exceed annual profits. However, group contributions are only possible between companies that have been in the same group for the entire financial year, or (much simplified) since the subsidiary began conducting business of any kind.

**Withholding tax**

There are no withholding taxes on interest payments or domestic dividend distributions (unless paid to physical persons or the estate of a deceased person in Sweden) under Swedish law, but a dividend distribution to a non-Swedish company does, in principle, trigger a 30 per cent withholding tax. In practice, however, this withholding is usually avoided as a result of applicable exemptions under domestic law in which (much simplified) the receiving entity is comparable with a Swedish limited liability company or it is a beneficiary under a comprehensive tax treaty. Furthermore, holding requirements may apply. The domestic rules are more generous than the minimum requirements under the Parent–Subsidiary Directive.4

### III SECURITY AND GUARANTEES

Leveraged finance transactions are normally backed by a comprehensive security and guarantee package where material group companies provide guarantees as principal obligor as for their own debt in respect of the borrower’s and the other guarantors’ obligations. As discussed below, financial assistance rules exist that limit the possibilities for Swedish target companies to guarantee and provide security for acquisition debt. Therefore, the guarantees and security provided by the target group would at least initially only cover facilities to refinance existing indebtedness and facilities for general corporate purposes or add-on acquisitions.

#### i Security packages

Acquisition financing (if leveraged) is commonly secured by (at least) a pledge of shares in the acquiring entity, the target company and other material companies in the target group. The material group companies are also typically guarantors, and provide security together with other group companies needed to fulfil certain guarantor coverage tests. Corporate bonds on the Swedish market are either secured or unsecured. Even fully secured bonds usually do not benefit from a security package as extensive as that for traditional bank financing, and may in this sense be considered a more flexible source of funding.

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As mentioned above, two of the most common types of collateral (assets) are shares (security over which is created by pledge, i.e., delivery of share certificates endorsed in blank and notification to the company) and structural intragroup loans, which are contractual rights (if structured as a non-bearer instrument, perfected by notification to the relevant debtor and an instruction that payments can only be made to the pledgee). The reason shares and intragroup loans are seen as ‘market standard’ to provide as collateral is because security can be granted and perfected immediately on closing, and because they are not associated with any stamp duty or further measures such as registrations with Swedish authorities. Depending on the nature of the business of the borrower group, further types of security may also be provided.

Further examples of security and collateral in Sweden are listed below (this list is not exhaustive):

- **Real property**: a real property mortgage creates a priority in specific real property up to the amount of the mortgage certificate. Any existing mortgage certificates held by a guarantor are typically part of the security package in a leveraged financing, but the issue of new mortgage certificates is often avoided as it entails stamp duty;

- **Movable property in general**: a business mortgage is a kind of floating charge that creates a priority up to the amount of the business mortgage certificate in substantially all movable property (subject to certain limitations) of the mortgagor from time to time. Any existing business mortgage certificates held by a guarantor are typically part of the security package in a leveraged financing, but the issue of new mortgage certificates is often avoided as it entails stamp duty;

- **Bank accounts**: it is possible to pledge bank accounts, but, for the pledge to be perfected (i.e., to be enforceable against third parties such as other creditors), the pledgor cannot dispose over the account or the balance of the account, so the account needs to be blocked. Therefore, it is often of limited value to pledge bank accounts in Sweden;

- **Invoices, trade receivables and contractual rights**: like bank accounts, the security arrangements must exclude the pledgor from collecting or disposing of the receivable, which makes security over receivables tricky to obtain other than for long-term receivables;

- **Intellectual property rights**: patent and trademarks can be pledged by registration in the relevant public registers; and

- **Pledges over ships and aircraft and mortgages on ships and aircraft**.

In addition to the above, security can arise, rather than be created, in certain situations; for example, when a party has assets in its possession, that party may exercise a retention right and hold on to such assets pending payment of an outstanding debt. In many situations, set-off rights can also provide a sort of security.

Second-ranking security is also possible. In cases of enforcement, the first-ranking pledgee can enforce the pledge and apply the monies received against the debt owed. The second-ranking pledgee can only receive any surplus once the first-ranking debt is paid. Where senior lenders and mezzanine lenders or bond holders or other creditors have entered into an intercreditor agreement, however, it is more common for a security agent to represent all lenders and to follow the order of priority set out in the intercreditor agreement rather than for the mezzanine lenders or other lower-ranking lenders to take a second or third-ranking pledge.
At the moment, chattels are transferred or pledged according to the principle of *traditio* (with the exception for certain registration). Much simplified, chattels have to come into the possession of the new owner or pledgee for the transfer or pledge to be effective against third parties.

### ii Limitations on security and guarantees

There are limitations on the granting of security and guarantees by a Swedish limited liability company. The limitations relate to what is generally referred to as the general loan prohibition, financial assistance and value transfers, respectively, discussed further below. Different provisions apply for regulated entities, state entities, foundations and other legal entities or private persons.

#### General loan prohibition

Under Swedish law, a limited liability company may not grant loans, or provide security or guarantees, to a natural person or legal entity who is a shareholder, director or managing director (including spouses and close relatives) in the company or in another company within the group, or to legal entities controlled by any such person (general loan prohibition). There are exceptions to the general loan prohibition, two of the most common being as follows:

- when the debtor is an entity within the same group as the company granting the loan or security. This exception is the most common exception, and is applicable when the parent entity is a Swedish or foreign legal entity domiciled within the EEA; and
- a company may grant loans, security or guarantees, or a combination thereof, if the loan, security or guarantee, or a combination thereof, is intended exclusively for the borrower’s business operations and the company provides the loan, security or guarantees, or a combination thereof, for purely commercial reasons.

#### Financial assistance prohibition

A Swedish limited liability company may not grant loans, security or guarantees, or both, for the purpose of a purchaser (hereinafter acquiring entity) acquiring its shares or shares in its direct or indirect parent company (financial assistance prohibition).

The rationale behind the provision is to prevent an acquiring entity without sufficient funds or that is unable to obtain external financing on its own merits from acquiring the company by using the assets of the company to pay (or secure) the payment of the purchase price. The financial assistance prohibition is only applicable if the loan, security or guarantee, or a combination thereof, is made or resolved prior to, or in connection with, the acquisition. In practice, this means that in transactions where the financial assistance prohibition may be applicable, the target companies do not grant security and guarantees (nor do they undertake to do so) until a certain time post-closing, and such guarantees and security are subject to limitation language except in the acquiring entity and its parent companies.

Strictly, the financial assistance prohibition only applies when the acquisition involves shares in the company, or a company above the company with a direct or indirect Swedish parent company. Hence, if the shares of any other foreign parent company are acquired, the financial assistance prohibition will not strictly apply, but this must be assessed on a case-by-case basis.
Value transfers and corporate benefit

A Swedish limited liability company may not make dividends in excess of its distributable funds (as set out in the latest adopted annual financial statement) less the amount needed to prudently cover the company’s restricted equity taking into account the needs of its business and that of its subsidiaries (if any) (the ‘prudency rule’).

If a Swedish limited liability company guarantees or grants security for another entity’s debt and the guarantee or security are not in the corporate (commercial) interest of the company (or if the guarantees or security are in excess of what is in the company’s corporate interest), the transaction constitutes a value transfer comparable with a dividend. Thus, when a company is providing a guarantee or a security for a third party’s obligation, whether the company gains any benefit from the transaction must be taken into consideration. The issue of corporate benefit is a business decision, and is ultimately a question for the board of directors of the company to determine before entering into a transaction. If the transaction is deemed a value transfer, it is subject to the limitations concerning dividends and requires the consent of shareholders. A value transfer is, therefore, unlawful if it exceeds the amount of the distributable funds after considering the prudency rule.

iii Concerns regarding security before commencement of insolvency proceedings

There are two types of insolvency proceedings in Sweden: bankruptcy and company restructuring. In both proceedings, recovery actions can be taken to claw back certain transactions carried out prior to the start of the insolvency proceedings if these actions have been detrimental to the interest of other creditors. Note that the below only highlights the most commonly used clawback grounds used to challenge or invalidate security.

Security provided by a Swedish entity during a three-month ‘hardening’ period (calculated backwards from the date on which the entity applied for bankruptcy or company restructuring) is vulnerable to clawback unless it was provided (and perfected) when the debt was created or was transferred without delay after the creation of the debt.

Furthermore, if a lender could be deemed to be a closely related party to a debtor (and pledgor), the hardening period is significantly increased. In relation to security provided after the creation of a debt, as per the example above, and if the security was transferred to a person or legal entity who is a closely related party to the debtor, the recovery period is up to two years before the debtor filed for bankruptcy and may be subject to clawback unless it is shown that the debtor neither was, nor by the action became, insolvent.

Security or other rights of a lender may also be affected by improper actions. Improper actions include a situation where a creditor has been favoured at the expense of other creditors, assets of the debtor have been transferred beyond the control of the creditors or the debts of the debtor have increased to the detriment of the creditors. The recovery period in the event of improper actions is five years, provided that the debtor was insolvent when the transaction was executed, or became insolvent as a result of the transaction itself or in conjunction with other actions and the counterparty was aware or should have been aware of that and the basis for the action being improper. A closely related party is deemed to be aware of the above unless it can show on a balance of probabilities that it was neither aware nor should have been aware. There is no limit on the recovery period on actions or transfers in relation to closely related parties.
IV  PRIORITY OF CLAIMS

i  Legal order of priority

The priority of claims and order of payment in a Swedish bankruptcy are stipulated in the Swedish Rights of Priority Act\(^5\) and the Swedish Bankruptcy Act,\(^6\) the main principles of which are as follows:

\(\begin{align*}
& a \text{ claims against the bankruptcy estate (such as fees or costs of the bankruptcy administrator, and also costs accrued by the estate during the bankruptcy proceeding (e.g., VAT claims or claims from third parties due to agreements that they have entered into with the bankruptcy administrator));} \\
& b \text{ claims with specific priority (e.g., pledges over shares in subsidiaries, trademarks, patents and thereafter business mortgages and real property mortgages);} \\
& c \text{ claims with general priority (e.g., certain employees’ claims for wages and other compensation, certain accounting costs);} \\
& d \text{ claims without priority (which normally rank equal in priority (\textit{pari passu}) and will be satisfied proportionally); and} \\
& e \text{ subordinated claims.}
\end{align*}\)

The concept of equitable subordination does not exist as such in Sweden, but a lender’s relation to the debtor can have other implications, in particular in relation to clawback periods (as briefly described above) for security and guarantees.

ii  Intercreditor agreements and structure

Structural subordination of mezzanine lenders or bond holders as opposed to senior lenders has been quite common in the Swedish leveraged finance market, but it has never been the only method used. Senior lenders sometimes agree not to have structural seniority but rely instead on intercreditor agreements or subordination agreements to ensure their priority. It is unclear, however, to what extent a bankruptcy administrator would abide by the intercreditor agreement when making payments from the bankruptcy estate. The first-priority creditor may, therefore, need to rely on the turnover provisions rather than the general priority in cases of bankruptcy of the debtor.

The use of often simplified Loan Market Association-based intercreditor agreements is widespread in the Swedish leveraged finance market, but there are certain national peculiarities that may be noted.

As mentioned above, it is not certain that a Swedish administrator dealing with a bankruptcy or company restructuring in the debtor company would follow the intercreditor agreement rather than applying the legal priority. In this case, the first priority lenders may need to rely on the turnover provisions of the intercreditor agreement.

Release of intragroup debt or shareholder debt in an enforcement scenario has never been tried by a Swedish court. For this reason, lenders with a share pledge commonly also request a pledge over any material shareholder or intragroup loans going into the pledged entity, so that they will be able to sell the loans and the shares to the same buyer.

\(^{5}\) 1970:979.

\(^{6}\) 1987:672.
Under Swedish law, there is no equivalent to the common law concept of a trust; consequently, there are no provisions under Swedish law that deal specifically with the function of a foreign law trustee. The common assumption, however, is that a trustee would most likely be considered an agent or otherwise an entity with a power of attorney to act on behalf of the lenders.

Under Swedish law, to avoid any potential grounds to challenge the perfection of the security, a pledgor should not be allowed to dispose freely of a pledged asset and the pledgee should not be obliged to release security at the simple request of the pledgor (subject to certain limitations). It is, therefore, often stipulated that Swedish security is not automatically released in connection with permitted disposals, for example, but rather is subject to the security agent’s active release, and the security agent should retain a certain discretion as to whether the release is given.

V JURISDICTION

Generally, Swedish courts will recognise and apply a foreign choice of law clause unless, for example, it would be contrary to Swedish public policy or mandatory rules of Swedish law to do so. However, if security is to be provided over assets situated in Sweden, our recommendation would be to have the security perfected in accordance with Swedish law in addition to the chosen foreign law because, under Swedish international private law rules, Swedish law would be applicable to in rem rights. Swedish courts may recognise the validity of a security interest created under a non-Swedish law security document, assuming it is valid under the law of the security documents, but the enforceability in Sweden is nevertheless subject to the requirement that necessary actions were taken under Swedish law to create the relevant form of security.

The parties can submit to the jurisdiction of an arbitration institute or a foreign court. However, if an agreement is governed by Swedish law, it would not be advisable to choose a foreign court or a foreign arbitration institute as such institutions may not be accustomed to applying Swedish law. Further, it is not certain that a Swedish court would consider itself to be the appropriate forum at the request of the lenders, for example, if another forum has been agreed but the right has been reserved for the lenders to also bring proceedings before the courts in any country where the obligors may have assets.

A judgment obtained in the courts of any EU Member State or Norway, Switzerland or Iceland would be recognised and enforceable in Sweden; however, in certain cases administrative actions might have to be taken (e.g., a foreign judgment sometimes needs to be referred to the relevant district court). Sweden is also a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958. A judgment obtained in the courts of any other foreign jurisdiction would as a starting point not be enforceable in Sweden; however, this judgment could be used as evidence in a Swedish court.
VI ACQUISITIONS OF PUBLIC COMPANIES

The main body of rules relating to takeover offers regarding companies with their shares or depositary receipts admitted to trading on a regulated market in Sweden is the Act on Public Takeovers, which is based on the EC Takeover Directive, and the takeover rules of the Nasdaq Stockholm. In addition to these takeover rules, the Swedish Companies Act, Swedish securities legislation (e.g., with respect to disclosure requirements of substantial holdings, insider dealing and reporting requirements to the Financial Supervisory Authority) and statements by the Swedish Securities Council perform an accessory role in regulating takeover matters.

As regards financing of take-private acquisitions, the Swedish takeover rules stipulate that a takeover bid may only be made after preparations have been made to demonstrate that the offeror is capable of implementing the offer. This includes a form of certain funds requirement, and the offeror must ensure that sufficient financial resources are available throughout the offer period.

Several disclosure requirements in connection with a take-private offer concern financing, and the offeror must disclose, for example:

- the main terms of the offer, including the price, any premium and the basis for calculating the premium;
- how the offer is financed (in detail, although not the fees);
- conditions for withdrawal of the offer; and
- subscription or underwriting commitments received in respect of a cash issue necessary for completion of the offer.

There are also confidentiality and insider restrictions to consider, as a takeover offer always (up and until it has been made public) constitutes insider information and, for example, a syndication of the loan would then be subject to confidentiality since it could be insider information.

An offer may be made subject to conditions that entitle the offeror to withdraw the offer. The conditions must be described in detail and must be objective (i.e., they must not depend solely on the subjective judgement of the offeror, or the fulfilment of the conditions is in its hands). An offeror may make the offer conditional on a lender disbursing the acquisition loan. A condition to completion of this nature gives the offeror an opportunity not to complete the offer in the event of breach by the lender of a facility agreement (e.g., due to insolvency or refusal to permit drawdown). Conditions for drawdown of the loan under a facility agreement, however, may not be invoked generally as grounds for not completing the offer. To be invoked, these conditions must be set out as specific conditions for completion of the offer (and thereby must comply with the requirement for, for example, objectivity) and not in the loan agreement. As a result, reliance on the conditions will be subject to an assessment of materiality by the Securities Council. The conditions on a lender paying the loan shall be stated in the press release (and the offer document).

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9 The Nordic Growth Market (NGM) has identical rules for its main market. For companies with their shares or depositary receipts listed on the multi-trading facilities First North, Nordic MTF and AktieTorget, similar rules apply.
A shareholder in a listed company may pledge its shares. It may also be noted that certain disclosure requirements may arise in the event that a pledgee must enforce its security, and if it acquires the shares itself and becomes a shareholder. The disclosure thresholds are 5, 10, 15, 20, 25, 30, 50, 66⅔ and 90 per cent of the shares or votes. The 90 per cent threshold (of the shares) is also the threshold for invoking minority squeeze-out. The takeover rules also contain rules on mandatory offers, and the requirement to make a mandatory offer is triggered when a party (or parties acting in concert) acquires shares and thereby reaches or exceeds a threshold of 30 per cent of the votes in a target company. However, it is unlikely in practice that these rules would ever pose a risk that a pledgee would be compelled to make an offer on the entire company, because the rules would not apply unless the pledgee, rather than a third party, would have acquired the shares from a share enforcement.

VII THE YEAR IN REVIEW

The market is still a ‘cove-lite/cove-loose’ market, and companies continue to raise a lot of financing. However, lenders have started to be slightly more stringent.

The trend for some time has been that the banks promote bond financing to limit the exposure on their own balance sheet and request other banking business to be willing to act as lender. Although the market is booming, we see an increase in the number of defaulting borrowers.

In June 2019, the Preventive Restructuring Framework Directive\(^\text{10}\) was adopted by the EU, and the Member States must incorporate this directive within two years, subject to certain exceptions. This will result in a need for beneficiaries of security or guarantees, and the parties to an intercreditor agreement, to review their position.

VIII OUTLOOK

As noted in Section I, the Swedish market has long been dominated by bank financing as the main means of acquisition and leveraged financing, and domestic banks have dominated the market. Although alternative means of financing, such as corporate bonds and alternative debt providers, have grown considerably during the past decade, bank financing has remained the primary source of acquisition financing. For other type of financings, the bond market is growing stronger.

The banking sector continues to remain subject to regulatory developments, primarily as a consequence of increased regulatory efforts within the EU.

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\(^{10}\) Directive on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency, and Discharge Procedures (2016/0359).
Chapter 17

SWITZERLAND

Lukas Wyss and Maurus Winzap

I OVERVIEW

The Swiss market for acquisition and leveraged finance is still very much influenced by the low interest rate environment. The Swiss National Bank (SNB) still applies negative interest rates on larger sight deposit account balances in Swiss francs of -0.75 per cent. Even though interest rates in the Swiss franc market continue to be at low levels, the rates recovered slightly. However, players in the market agree that interest rates in the Swiss franc market will only increase more significantly, once interest rates in the euro market are increasing.

Nevertheless, as a consequence, the lack of investment opportunities at attractive yields has had a significant influence on investor appetite, also in the acquisition and leveraged finance space, and leverage ratios have been further pushed to levels close to levels seen in the market prior to the financial crisis of 2007. In addition, borrowers are able to negotiate contractual terms that are very light (covenant light).

So far, only few transactions involving debt funds or unitranche lenders have been seen in the Swiss market, but it appears that it will only be a question of time until those debt investors will further enter the Swiss market. However, in light of the 10/20 Non-Bank Rules (see below), the lending by funds to Swiss borrowers requires further structuring.

Also, where possible, Swiss borrowers in need of Swiss franc funding tried to tap the euro or the US dollar market, as they can get a considerable benefit out of the cross-currency swap.

Transactions seen in the Swiss market during the past 12 months included leveraged buyouts of large private Swiss targets, as well as a substantial number of smaller buyouts.

Large Swiss acquisition finance transactions are usually arranged through the London or US market and are placed with banks and institutional investors. Like in many other jurisdictions, these structures included either the placement of acquisition term-loan tranches with institutional investors (rather than banks), the issuance of high-yield notes, or both.

In some transactions, bridge financing was provided to facilitate the acquisition process and the closing mechanics, and taken and refinanced by the high-yield notes financing as soon as possible after closing.

Debt packages for large leveraged acquisition finance transactions varied, inter alia, depending on the volume and leverage required. The transactions consisted of either senior debt only; or senior debt and one or several layers of junior debt.

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1 Lukas Wyss and Maurus Winzap are partners at Walder Wyss Ltd. The information in this chapter was accurate as at November 2018.
In most cases, the debt package was completed by a (revolving) working capital facility lent at the target level and structured as super-senior debt. The super-senior level derives from the structural preference and is usually also reflected in intercreditor arrangements.

Smaller Swiss domestic acquisition finance transactions, on the other hand, are often financed by Swiss banks, including Swiss cantonal banks and smaller financial institutions. These financings are usually held by the banks on their balance sheet until full repayment of the financing. In those types of transactions, the decision to lend is often supported by cross-selling opportunities. However, non-bank lenders have become more and more competitive, as they may offer more flexibility in terms of pricing. In Swiss domestic finance transactions, strong borrowers and sponsors have been successful in negotiating slim security packages to further reduce transaction costs and enhance flexibility.

II REGULATORY AND TAX MATTERS

i Regulatory matters

The mere provision of acquisition finance does not itself trigger a licensing requirement under Swiss laws. A licensing requirement would only be triggered if lenders would refinance themselves in Switzerland by means of accepting money from the public or via a number of unrelated banks. Lending into Switzerland on a strict cross-border basis is currently not subject to licensing and supervision by the Swiss Financial Market Supervisory Authority FINMA.

On 15 June 2018, the Swiss parliament passed the last pieces of legislation of the overhaul of the Swiss financial regulatory framework, namely the Swiss Financial Services Act (FinSA) and the Swiss Financial Institutions Act (FinIA). The FinSA and the FinIA are expected to enter into force on 1 January 2020. The FinSA introduces a new register of financial advisers. Under the FinSA, financial advisers of foreign financial institutions may only be active in the Swiss market once they are registered in the register of financial advisers. It very likely that a person advising exclusively in the context of finance (lending) transaction will be out of scope of the registration requirement, but given the lack of clear guidance, it remains yet to be seen how the new FinSA will be dealt with in practice.

ii Tax matters

The tax structuring of acquisition finance transactions is more challenging, in particular due to the Swiss Non-Bank Rules.²

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² The Swiss Non-Bank Rules comprise two rules: the Swiss 10 Non-Bank Rule and the Swiss 20 Non-Bank Rule. The Swiss 10 Non-Bank Rule defines, inter alia, the circumstances in which a borrowing by a Swiss borrower or issuer will qualify as ‘collective fundraising’ (similar to a bond). If the borrowing qualifies as collective fundraising, interest payments on the borrowing will be subject to Swiss withholding tax at 35 per cent.

Under these Rules, withholding tax will be triggered when either a lending syndicate consists of more than 10 non-bank lenders (Swiss 10 Non-Bank Rule) or a Swiss obligor has, on aggregate (that is, not in relation to a specific transaction only), more than 20 non-bank creditors (Swiss 20 Non-Bank Rule).
When structuring a syndicated finance transaction involving Swiss borrowers to comply with the Non-Bank Rules, the usual approach is to limit the number of non-banks (investors) to 10. This approach is obviously not feasible in larger leveraged acquisition finance transactions, where term-loan tranches or notes are placed outside of the banking market. Accordingly, funds under these transactions may not be raised by a Swiss borrower or issuer, but rather through a top-tier acquisition vehicle incorporated abroad in a jurisdiction that has a beneficial double tax treaty with Switzerland (for the purposes of up-streaming dividends without withholding any amounts). Given the generally beneficial double tax treaty between Switzerland and Luxembourg, typical structures often involve multilevel acquisition vehicles incorporated in Luxembourg.

If funds raised by a non-Swiss borrower are lent on within the group to a Swiss target company, this may be regarded as a circumvention by the Swiss Federal Tax Administration (SFTA). This is especially relevant if the Swiss target company guarantees and secures the acquisition financing. However, the SFTA has previously considered and approved structures that have included these structural elements by way of binding tax rulings. Nevertheless, the process must be carefully structured, with due consideration of the time needed for the tax rulings.

If the transaction includes a (revolving) working capital facility lent directly to the (Swiss) target companies, compliance with the Swiss Non-Bank Rules can only be achieved by limiting the number of non-banks to 10. To ensure the acquisition debt portion of the financing (which typically has more than 10 non-banks as lenders or noteholders) does not affect the working capital facility, it is key to structure these facilities in order for them to qualify as separate financings for the purposes of the Swiss Non-Bank Rules. Against this background, loss sharing provisions and similar (equalisation) provisions contained in intercreditor arrangements must also be carefully structured or confirmed by the SFTA (by way of a tax ruling) against the Swiss Non-Bank Rules.

**Deductibility of interest expense**

Under Swiss tax law, interest incurred at the level of the acquisition vehicle is not available for set-off against income generated at the Swiss target company level for income tax purposes. This is because there is generally no tax consolidation under Swiss tax law (neither in Swiss domestic nor cross-border situations). However, there are means to (indirectly) ‘push down’ the acquisition debt portion, particularly if the existing debt can be refinanced at the target level. For the purposes of the Swiss Non-Bank Rules, this would need to be structured as a downstream loan from the acquisition vehicle to the target level (or by refinancing the existing debt at the target level, although that would result in a limitation of the number of non-banks to 10 for that portion of the debt in any event). However, since the proceeds of the acquisition debt may be lent on, the Swiss Non-Bank Rules have to be carefully addressed.

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For the purposes of the Swiss Non-Bank Rules, a financial institution qualifies as a bank (whether the financial institution is Swiss or non-Swiss) if it is licensed as a bank and it performs genuine banking activities with infrastructure and own personnel.

A breach of the Swiss Non-Bank Rules may result in the application of Swiss withholding taxes. Such taxes would have to be withheld by the Swiss obligor and may (depending on any applicable double taxation treaty) be recoverable in full or partially by a lender.
Alternatively, an (indirect) pushdown can be achieved by way of an equity-to-debt swap, where equity (freely distributable reserves or even share capital that can be reduced) is distributed (but not actually paid out) and converted into a downstream loan. In recent transactions, additional pushdown of debt potential has been created by some post-acquisition restructuring steps (such as group internal sales of assets generating additional earnings and the respective debt capacity).

If such a pushdown can be achieved, some of the interest incurred on the acquisition debt may be brought to the target company level and become available for set-off against income generated at the target level. The security package structure may be improved in connection with such pushdown at the same time.

III SECURITY AND GUARANTEES

i Standard security package at closing

In leveraged acquisition finance transactions involving Swiss target companies, the acquisition debt portion usually benefits from the share pledge over the top Swiss target company. In most cases, the security package is completed by other security provided by the acquisition vehicle, such as security over:

a claims and rights under the share purchase agreement;
b claims and rights under due diligence reports;
c claims and rights under insurances (in particular, M&A insurances, if any); and
d bank accounts.

Share pledge

Under Swiss law, shares in stock corporations and limited liability companies may be pledged by written agreement and if share certificates have been issued by handing over the certificate to the pledgee (duly endorsed or assigned (as applicable) in blank in the case of registered shares). If certificates have been issued, the handover of such certificates is a perfection requirement for the pledge. While a pledge over shares can be perfected, even if no certificates have been issued, the issuance and handover of certificates it is generally considered to bring the pledgees into a factually stronger position in the event of enforcement. In addition, it is standard that any transfer restrictions in the target company’s articles of association are removed. Provisions in the articles of association limiting the representation of shareholders at shareholders’ meetings to other shareholders must also be lifted to ensure full flexibility once control over the shares has been gained. Given the lack of control over the target company pre-closing, the issuance of certificates and the amendment of the articles of association are generally accepted as conditions subsequent.

Claims and receivables

Claims and receivables (claims under the share purchase agreement, insurance claims, claims under due diligence reports, etc.) may be assigned under Swiss law for security purposes by means of a written agreement between assignor and assignee. The agreement must specify the relevant claims and may cover future claims as well, provided claims are described in a manner that allows for clear identification once such claims come into existence. However, it must be noted that claims arising post-bankruptcy with a Swiss assignor would no longer be validly assigned and would be trapped in the bankrupt estate.
While assignability is generally given under Swiss law in the event that the underlying agreement is tacit as regards or explicitly allows for an assignment, it is important that the underlying agreement does not contain a ban on assignment. Therefore, during the pre-signing phase, the parties must ensure that all relevant documents do not contain any restrictions on assignment (particularly the share purchase agreement, insurances, etc.) and, for the sake of clarity, it is even recommended that important agreements explicitly allow for an assignment for security purposes to financing parties. The same applies to any due diligence reports, although getting the benefit through reliance will also be satisfactory in most circumstances (either directly derived from the report or through additional reliance letters).

Although the requirement to notify third-party debtors (such as the sellers) is not a perfection requirement under Swiss law, it is strongly recommended that these parties are notified of the assignment for security purposes and the transaction as a whole, because a third-party debtor might, prior to notification, validly discharge its obligation by paying to the assignor.

**Bank accounts**

Security over Swiss bank accounts is typically provided by pledging the claims the account holder has against the account bank. An assignment for security purposes would also be possible (and would even be a slightly more direct security right), but account banks have become increasingly concerned in the past two years about ‘know your customer’ and beneficial owner identification issues, because the assignment is, legally, a full legal transfer, while the pledge only provides for a limited right *in rem*. Again, a notification of the account bank is not a perfection requirement, but it is standard practice in the Swiss market to notify the account bank and seek its confirmation as to waiving all priority rights in relation to the relevant bank accounts on the basis of its general terms and conditions and otherwise. Such a confirmation should also outline the mechanisms on blocking the account upon further notification.

**Timing of providing security on closing**

The security interest provided by the acquisition vehicle may be entered into and perfected pre-closing, except for the share pledge, which may only be perfected upon closing of the transaction, immediately after the acquisition of the shares by the acquisition vehicle. From a Swiss point of view, there is nothing that would make it overly burdensome or impossible to perfect the security interest as soon as the transaction is completed or closed. However, some items (such as the amendment of articles of association or notices) will have to become post-closing items, but, as described above, that does not prevent the perfection of the security interest as such.

**Standard target-level security package**

Security is typically granted by the Swiss target companies. The target-level security package is similar to fully fledged security packages in other jurisdictions and may include, inter alia, security over:

- shares in subsidiaries;
- trade receivables;
- intercompany receivables;
- insurance claims;
- bank accounts;
intellectual property; and
real estate.

See above for a description of security over most of these assets.

However, in smaller transactions and depending on the level of leverage provided, sponsors are sometimes able to negotiate a slimmer security package for purposes of avoiding transaction costs. This is particularly true in pure Swiss domestic deals and in case the taking of security would require involvement of additional foreign counsel. In addition, in Swiss domestic finance transactions, borrowers often are successful in negotiating slim security packages as a consequence of the strong negotiation power that borrowers currently have in the finance market.

Real estate

Security over real estate is typically taken by way of taking security over mortgage certificates. A mortgage certificate is issued either in bearer or in registered form. Alternatively, since January 2012, a paperless version of a mortgage note can be created which is evidenced by electronic registration in the relevant land register. A mortgage note creates personal, non-accessory claim against the debtor, which is secured by a property lien. Unless preexisting mortgage certificates are available, the creation of new mortgage certificates requires a notarised deed and registration of the mortgage certificate in the land register. Once created, the mortgage certificates will be transferred for security purposes under a written security agreement without further notarisation or entry into the land register (except in the case of paperless mortgage certificates).

One important tax point has to be considered as interest payments to non-Swiss resident creditors of loans secured by Swiss real estate are subject to withholding tax at source, unless the lender is located in a jurisdiction that benefits from a double tax treaty with Switzerland providing for a zero rate. Accordingly, if a Swiss borrower is involved, it must be ensured that only ‘Swiss treaty lenders’ will be secured by real property to avoid the risk of withholding tax being applied to interest payments. Swiss treaty lenders are persons:

a having their corporate seat in Switzerland or are lending through a facility office (which qualifies as a permanent establishment for tax purposes) in Switzerland, and that are entitled to receive any payments of interest without any deduction under Swiss tax law;
or

b lending in a jurisdiction having a double tax treaty with Switzerland providing for a zero per cent withholding tax rate on interest payments.

In particular, owing to these tax issues, security over real estate is normally only considered if there is substantial real estate located in Switzerland.

If a foreign borrower is involved (such as a foreign acquisition vehicle), the issue basically remains the same, but an application for an exemption through a tax ruling application may be considered. While such a tax ruling has been obtained very recently in a few cantons, the process of being granted such a ruling in other cantons might be quite lengthy and, therefore, costly (while the outcome is possibly vague). Without a satisfactory tax ruling, real estate located in Switzerland cannot be granted as security owing to the risk of potential withholding tax on interest payments.
**Intellectual property**

Under Swiss law, security over intellectual property is typically taken by way of pledge. A written pledge agreement is required, specifying the intellectual property right. As a matter of Swiss law, no registration is required for the valid perfection of the pledge over intellectual property. However, if not registered, the intellectual property may be acquired by a *bona fide* third-party acquirer, in which case the pledge would become extinct. While a Swiss law pledge over foreign intellectual property is valid as a matter of Swiss law, it should be double-checked whether the validity of the security interest would also be recognised under relevant foreign law, or whether — as an example — its registration would be a perfection requirement. Accordingly, with regard to foreign intellectual property of certain importance and value, it is advisable to register the pledge in the relevant register. Security agreements typically provide for a registration obligation for the pledge over important intellectual property on day one and for all other intellectual property upon the occurrence of an event of default.

**Difficulties in taking security over movable assets**

Owing to strict repossession requirements under Swiss law, taking of security over movable assets (such as an inventory or equipment) without substantially disturbing the daily business of the security provider is difficult. There are structuring solutions surrounding this issue (such as pledge holder structures or opco or propco structures), but these solutions are usually only implemented in situations where there is a specific focus on a specific asset (raw materials with substantial value, larger car fleets, aircraft parts, etc.).

**Timing of providing target-level security**

Unless there is some cooperation on the part of the seller to start preparing target-level security pre-closing (and depending on the exact release mechanisms from existing financings), target-level security might only be available post-closing, and it is usually agreed that target-level security might be completed as a condition subsequent.

iii **Financial assistance and upstream and cross-stream security/guarantees**

Standard upstream and cross-stream limitations will apply to Swiss target-level guarantees and security. Essentially, the amount of proceeds under upstream and cross-stream security or guarantees that is available to lenders is limited to the amount that the guarantor/security provider could distribute to its shareholders as dividends at the point in time of enforcement. In addition, certain formal requirements will have to be followed both, upon granting and enforcement of the security or guarantee. These limitations may affect the security substantially, particularly in situations of financial distress. However, if structured properly and if using all available mitigants, such limitations are generally accepted by investors and lenders.

In October 2014, the Swiss Federal Supreme Court ruled, that upstream and cross-stream loans that do not meet the at arm’s-length test will also reduce the distributable amounts of the lender. However, at the same time, the Swiss Federal Supreme Court ruled that paid in surplus is generally available for distribution to shareholders. It would appear that parties have applied a more cautious approach around the granting of upstream and cross-stream loans since October 2014, but transaction structures generally remained unchanged. It remains to be seen whether further court rulings will be issued in this respect.
If the structure also includes a downstream loan from the acquisition vehicle to the Swiss target companies (often used for tax purposes as a pushdown of debt and for the repatriation of the cash flows), the Swiss target company may provide (unrestricted) security to secure such a downstream loan, because it would secure its own rather than parent debt. Accordingly, this would not qualify as upstream security. The acquisition vehicle in turn may provide security over the downstream loan, along with the (unrestricted) security package securing such a downstream loan. From a Swiss corporate law perspective, there is a good chance that upstream limitations will not apply to that security structure. However, such a security structure should be discussed with the SFTA in the light of the Swiss Non-Bank Rules.

IV  PRIORITY OF CLAIMS

i  Statutory priority of claims

Upon bankruptcy over a Swiss entity, certain creditors would benefit from statutory priority:

a  secured claims are satisfied with priority directly out of the enforcement proceeds; any surplus will be shared among (unsecured) creditors generally, and any shortfall would be treated as a third-class claim; and

b  claims incurred by the bankruptcy or liquidation estate or during a debt restructuring moratorium with the administrator’s consent rank above unsecured claims.

In relation to unsecured claims, there are three priority classes: the first class mainly consists of certain claims of employees as well as claims of pension funds; the second class consists of claims regarding various contributions to social insurances and tax claims; and the third class consists of all other unsecured claims.

ii  Contractual structuring of priority of claims

Within the third class, creditors and the debtor are free to contract on the ranking of such claims among themselves. Typically, in Swiss acquisition finance transactions, the priority of claims among various debt investors is reflected on the basis of intercreditor arrangements rather than on the basis of structural subordination. It should be noted, however, that in larger transactions, the acquisition structure is most often set up outside Switzerland. In addition, where the investor base would expect a structural subordination, such a structure is implemented, but rather for marketing purposes.

Under Swiss law, intercreditor arrangements that provide for the priority of claims are generally binding on the parties involved and also on insolvency officials of an estate. However, given that there are hardly any relevant precedents, it cannot be ruled out that an insolvency official would treat all non-secured creditors indiscriminately as third-class creditors, and consider the priority of payments as a mere arrangement among creditors of the estate in relation to their respective claims in relation to the estate and pay them out on a pro rata and pari passu basis. Such being the case, the parties to the intercreditor arrangement may have to rely on the redistribution by the creditors among themselves.
iii  Equitable subordination

The concept of equitable subordination is neither reflected in codified Swiss law nor well established in Switzerland. Even though there are no conclusive precedents, equitable subordination is generally only discussed in connection with shareholder loans. It is unclear whether the holding of a very small equity stake would be sufficient for a qualification of a loan as shareholder loan. It would appear that the terms of the loan and the circumstances under which it has been granted are more relevant than the specific percentage of shareholding. Against this background, it may be concluded that a loan granted in proportion to the shareholding of a small shareholder (together with all other shareholders) could be problematic, while the holding of a portion in a larger (syndicated) loan (at arm’s length) by a bank seems to be unproblematic, even if that bank would hold an equity stake in the relevant Swiss company.

Basically, a parent company will be treated as any other third-party creditor of such Swiss subsidiary in the framework of a Swiss bankruptcy proceeding. The risk of a shareholder loan being deemed to be either subordinated against all other (non-subordinated) creditors, or to be treated like equity (in which case, the parent company would only be satisfied together with all other equity contributors), arises only under very specific circumstances.

Elements that could be relevant are:

a  that the shareholder loan is granted in a situation where the Swiss subsidiary is already over-indebted;
b  that the parent company had (or should have had) knowledge of the over-indebtedness of its Swiss subsidiary while granting the shareholder loan;
c  that the granting of the shareholder loan resulted in the Swiss subsidiary having upheld its business activities, and accordingly in a deferral of the opening of bankruptcy proceedings over the Swiss subsidiary; and
d  that the deferral of the opening of bankruptcy proceedings results in a (potential) damage of other creditors of the Swiss subsidiary.

A few scholars suggest applying a stricter regime (per se subordination of shareholder loans in bankruptcy; application to the concept to third-party loans, etc.), but it must be noted that court decisions where the concept of equitable subordination has been applied are fairly rare and, accordingly, that this concept cannot be regarded as well established as such. Therefore, we see little leeway for the application of such a concept, in particular, where loans are granted on an arm’s-lengths basis and to Swiss companies that are not over-indebted.

V  JURISDICTION

The submission by a Swiss company to the exclusive jurisdiction of the courts of England or any other non-Swiss forum is generally binding on such a Swiss company. It should be noted, however, that under Swiss law, jurisdiction clauses may have no effect as regards actions relating to, or in connection with, insolvency procedures that, as a rule, must be brought before the court at the place of such an insolvency procedure. Furthermore, contractual submissions to a particular jurisdiction are subject to the mandatory provisions on the protection of consumers, insured persons and employees pursuant to the Lugano Convention, the Swiss Federal Private International Law Act (PILA) and such other international treaties by which Switzerland is bound. Pursuant to the PILA and the Lugano Convention, Swiss courts may also order preliminary measures even if they do not have jurisdiction over the substance of the matter.
Enforceability in Switzerland of a foreign judgment rendered against a Swiss company is subject to certain limitations set forth in: (1) the Lugano Convention; (2) the other international treaties under which Switzerland is bound; and (3) the PILA. In particular, a judgment rendered by a foreign court may only be enforced in Switzerland if:

a in the case of (2) and (3) and, in certain exceptional cases, (1), the foreign court has jurisdiction;

b the judgment of such foreign court has become final and is non-appealable or, in the case of (1), has become enforceable at an earlier stage;

c the court procedures leading to the judgment followed the principles of due process of law, including proper service of process; and

d the judgment of the foreign court on its merits does not violate Swiss law principles of public policy.

In addition, enforceability of a judgment by a non-Swiss court in Switzerland may be limited if the Swiss company demonstrates that it has not been effectively served with process (a service of process on the Swiss company will have to be made in accordance with the Hague Convention).3

VI ACQUISITIONS OF PUBLIC COMPANIES

While the financing of public takeover transactions generally involves the same structural considerations as other leveraged acquisition financing transactions, a number of additional, specific elements arising from the public takeover regime must be considered. One of the main obstacles to overcome under Swiss law is the fact that the Swiss takeover board would not allow an acceptance threshold for the public takeover, which is as high as the level of control needed to proceed with a squeeze-out of minority shareholders and gain 100 per cent control over the target. In the context of financing a leveraged public takeover this constitutes a challenge, because there is a chance that the bidder will be stuck with a majority stake only (i.e., less than 100 per cent).

i Structuring of public tender offers and options for squeeze-outs

Under Swiss law, a public tender offer may contain only limited conditions and, in the event that these conditions are satisfied, the bidder is obliged to complete the transaction. One of the permitted conditions is to include an acceptance threshold (that is, the requirement to complete the transaction when a certain percentage of shares is tendered to the bidder). However, an acceptance threshold of more than two-thirds (66.66 per cent) will require the approval from the Swiss takeover board. Although there is a good chance that this threshold will be pushed to 75 per cent, it is unlikely that the takeover board will accept any threshold above 75 per cent.

3 Hague Convention of 15 November 1965 on service of judicial or extrajudicial documents abroad in civil and commercial matters.
Following the completion of a public tender offer (that is, after the lapse of the additional acceptance period), the bidder has the following options available to gain 100 per cent control over the target:

a squeeze-out merger: Under Swiss merger law, a minority squeeze-out is available if the majority shareholder holds at least 90 per cent of the Swiss target shares. A squeeze-out merger is usually effected by merging the Swiss target company with a newly incorporated (and 100 per cent-owned) affiliated company (preferably a sister company incorporated for this purpose). The process for merging the two companies would typically take between three and six months. However, minority shareholders have appraisal rights and can block the recording of the merger in the commercial register, which may delay the closing of the merger and, hence, the entire process. In addition, given the appraisal rights of minority shareholders, it is important to kick off the merger process (and the entry into force of the merger agreement) only six months after the lapse of the additional acceptance period in order to eliminate any risk of being in conflict with the ‘best price rule’. Under the best price rule, if the bidder acquires target shares in the period between the publication of the offer and six months after the additional acceptance period at a price that exceeds the offer price, this price must be offered to all shareholders; hence, there is a risk that through the appraisal rights that shareholders have in the merger process, a higher price may be determined, which must be potentially offered to all shareholders (also retroactively); and

b squeeze-out under Swiss takeover law: If, following a public tender offer, the bidder holds 98 per cent or more of the Swiss target shares, a squeeze-out of minority shareholders may be initiated. This process takes two to three months and involves a court ruling. The 98 per cent level must be reached within three months of the additional acceptance period expiring. Contrary to a squeeze-out merger, minority shareholders have no appraisal rights as they receive simply the offer price. Similarly, blocking the recording in the commercial register is not possible as the commercial register is not involved.

Following the completion of a public tender offer, if the bidder holds less than 90 per cent of the Swiss target shares, no squeeze-out will be available. Although the bidder may try to buy additional shares over the market (the best price rules will have to be closely monitored), or an additional public tender offer may be launched, there is no absolute certainty that the bidder would achieve 90 per cent. Once the 90 per cent threshold has been reached, a squeeze-out merger will become available again.

ii Certain funds requirements

Under Swiss law, certain funds requirements can be summarised as follows:

a certain funds must be available on the launch of the offer (i.e., publication of the final offer and the offer prospectus), and certain funds must be confirmed by a special auditor (it is, however, prudent for a bidder to ensure certain funds prior to announcement of the offer, because the bidder must proceed with the offer within six weeks of the prior announcement being published); and

b the offer prospectus must provide for financing details and confirmation from the special auditor.
Typically, only the very basic terms of the financing will have to be disclosed in the offer prospectus, and it would not be necessary to disclose details on pricing and fees and similar commercial terms.

Given the certain funds requirements, the financing may only contain limited conditions precedent. The Swiss takeover board has issued guidelines in this respect (it should be noted that supervisory authorities and courts are not bound by such guidelines, but the guidelines are still generally considered an important indication) and, according to these, the following conditions are generally acceptable:

a. conditions that match the conditions contained in the offer;
b. material legal conditions relating to the bidder, such as status, power, authority, change of control;
c. conditions relating to the validity of finance documents, in particular security documents and the creation of security thereunder;
d. conditions relating to material breaches of agreements by the bidder, such as pari passu, negative pledge, no merger, non-payment; and
e. material adverse changes in relation to the bidder.

Generally, however, market and target material adverse change clauses are not permitted.

### iii Consequences on financing and further considerations

**Potential financing structures**

Given the required structure of a public tender offer, the financing must be available and committed even though it is not absolutely certain that the bidder would ever gain 100 per cent control over the target. This situation is quite challenging from a financing perspective. This challenge could be approached in two ways:

a. one approach could be to simply apply a more conservative overall leverage; however, this might affect the overall economics of the transaction considerably, and will ultimately influence the bid price and the chances of the tender offer of being successful; or
b. alternatively, two different financing structures could be prepared.

The difficulty in preparing two financing structures is that parties would only know the exact structure upon the lapse of the additional acceptance period; hence, it might be challenging for the arrangers and book-runners, as there will only be a limited amount of time available between the lapse of the additional acceptance period and the close of the transaction for purposes of marketing the financing transaction.

If the bidder holds at least 90 per cent of the Swiss target's shares, the period from the first drawdown to the point where the bidder controls 100 per cent will still take a couple of months. In the squeeze-out merger scenario, it is prudent to wait until the best price rule has lapsed before entering into the merger agreement, as this would eliminate the risk of a successful appraisal action having retroactive effect on the offer price in the public tender offer (violation of the best price rule). Accordingly, it can be expected that the merger will be completed within eight to 10 months after the lapse of the additional offer period, but it is prudent to add an additional two months as a minority shareholder could potentially delay the process.
Interim period
While minority shareholders are in the structure, access to target-level cash flows is limited because it is difficult to structure upstream loans to a majority shareholder in a manner compliant with the principle of ‘equal treatment of shareholders’, and any leakage of dividends to minority shareholders should be avoided (this is true for two reasons: first, any leakage to minority shareholders would result in the bidder incurring a cash drain; and second, if the market ever found out that there were a chance for dividends to be paid ad interim (and any person involved in the structuring of the financing knew about this), this would be a bad sign for the success of the tender offer). Therefore, the transaction will require some overfunding to ensure a proper debt servicing during the post-closing period, when target-level cash flows are not available.

Furthermore, target-level security is not available in the interim period, because that would again raise questions under the principle of ‘equal treatment of shareholders’.

In addition, while the Swiss target company is still publicly listed, it is subject to ad hoc publicity obligations and, accordingly, information may only be provided to all investors at the same time, and any prior information for selected investors might raise concerns. Availability of information to majority shareholders and banks might also be limited owing to the concept of equal treatment of shareholders.

Delisting
As demonstrated, the squeeze-out options are limited and essentially only available if the bidder controls 90 per cent or more in the Swiss target company. However, a delisting of the Swiss target company would already be feasible in a scenario where the majority shareholder controls less than 90 per cent. SIX Swiss Exchange’s delisting directive was recently amended, and the period between announcement of the delisting and the last trading day will be set by SIX Swiss Exchange between three and 12 months. However, this period may be shortened if delisting occurs following a takeover process.

VII OUTLOOK
The most important change of law currently under discussion that would affect lending in Switzerland generally (and in particular leveraged acquisition finance transactions) relates to Swiss withholding tax. Switzerland is about to consider fundamental changes to its withholding tax system. Draft legislation was already published by the Swiss Federal Council on 24 August 2011. It was expected that the new regime would enter into force during the course of 2015 or 2016. However, in view of the negative outcome of the consultation on the draft legislation in the course of 2014 and 2015, the Swiss Federal Counsel decided on 24 June 2015 to postpone a complete overhaul of the Swiss withholding tax regime, as originally planned. The draft legislation suggested that the current deduction of 35 per cent by the issuer of bonds on interest payments at source would be substituted for a respective deduction by Swiss paying agents (subject, in principle, to an exception for foreign investors). This change should have, among other things, discouraged foreign bond and facilities issuances by Swiss groups and was thus supposed to strengthen the Swiss capital market. It now remains to be seen when and, if so, in what form the withholding tax reform will be relaunched. The paying agent principle should be discussed again before the planned exemptions for CoCo bonds, write-off and bail-in bonds expire.
Given the increased level of scrutiny from tax authorities, the pricing of intercompany guarantees (and other security) is likely to become one of the most contentious issues in transfer pricing. Tax authorities on their part will be concerned that corporate guarantee or security fees adequately reflect the heightened business failure and default. Taxpayers will in turn face the arduous challenge of determining what constitutes an arm’s-length guarantee or security fee at the time when rules of thumb and quick answers have become less reliable. Given the sums typically involved and the complexity of the issues faced, it will be important to consider multiple approaches in pricing intercompany guarantees and other securities.
Chapter 18

TURKEY

Umut Kolcuoğlu, Bihter Bozbay and İpek Yüksel

I OVERVIEW

The year 2018 was one of recovery; Turkish markets’ struggle with the effects of the previous years’ uncertainties has continued. The fluctuation of the Turkish lira, the increase in the borrowing costs and high inflation rates have halted the long-expected restoration of Turkish markets in 2018. In terms of the M&A markets, although the improvement recorded in 2018 was very modest in comparison to 2017, market activity in 2018 surpassed expectations in terms of deal value. Regarding political restoration, in 2019, the renewal of Istanbul municipal elections and shifting political winds have influenced the markets deeply and demonstrated the longing for stability and growth in Turkey.

According to the estimations of Deloitte, in the Turkish M&A market, the total deal volume in 2018 was US$12 billion with 256 deals. Given that the total deal volume in 2017 in Turkey was around US$10.3 billion through 295 transactions, a slight increase of 17 per cent was observed. In 2018, deals involving foreign investors were 63 per cent of the total deal volume (i.e., US$7.6 billion).

In the Turkish M&A market, acquisitions are typically financed with debt financing involving local and international banks, depending on the parties involved in transactions in the form of senior secured debt.

Following the introduction, by the Turkish Ministry of Treasury and Finance, of limitations on foreign currency loans obtained from abroad in early 2018, we have observed a significant decrease in foreign financing; both local and international banks seem to be reluctant to provide financing until the application of the new legislation is tested and the currency crisis is settled. Considering the expensive pricing offered by local banks, and tax-related challenges, clients often turn to international banks in acquisition finance deals; thus the limitations to foreign currency loans will continue to create an adverse environment in terms of the leveraged financing.

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1 Umut Kolcuoğlu is a managing partner, Bihter Bozbay is a partner and İpek Yüksel is an associate at Kolcuoğlu Demirkan Koçaklı Attorneys at Law.
3 Id, p. 3.
4 Id, p. 5.
II REGULATORY AND TAX MATTERS

i Regulatory matters

The most critical regulatory matter regarding acquisition finance deals in Turkey is the limits to the foreign currency borrowing that was introduced in early 2018. (See below for details of the limitation.)

A common debt product in Turkey is debt financing, whereby a financial institution lends money to the acquiring entity in the form of a term loan facility. Under Turkish law, money lending is supervised by public authorities. Only banks and financial institutions may lend money with the intention to make profit. Money lending by non-bank and non-financial institutions is prohibited and may constitute a usury crime under Turkish law, unless it is explicitly permitted by law.

Banking laws require Turkish companies to obtain a banking licence from the Banking Regulation and Supervision Agency to engage in any kind of banking activities in Turkey, such as the extension of any kind of loan and collection of deposits. Indeed, Turkish residents may, without any permission or licence from a Turkish regulatory authority, obtain loans (other than consumer loans) in Turkish lira or, subject to certain limitations, in foreign currency from banks, financial institutions or other entities (i.e., intragroup companies) resident abroad, provided that the proceeds of such loans are paid to an account of the Turkish resident acting as borrower held with a bank licensed in Turkey. In other words, a Turkish resident must bring borrowings from abroad via Turkish banks.

The new amendment has introduced a distinction for Turkish resident legal entities based on which currency they generate their income from, while prohibiting Turkish individuals from obtaining foreign currency loans or loans indexed to foreign currency from banks and financial institutions resident abroad. Turkish legal entities that generate foreign currency income can freely take out foreign currency loans from banks and financial institutions resident abroad. However, these entities are also required to have a loan balance\(^5\) of at least US$15 million on the date of utilisation; if not, the entire loan to be utilised and the current loan balance cannot exceed the borrowing entity’s foreign currency income of the past three years.

As a general principle, Turkish legal entities that do not generate foreign currency income are prohibited from taking out foreign currency loans from banks and financial institutions resident abroad. This prohibition will not be applicable in certain cases, for example, if the borrower is a bank, a public authority or a financial institution; or if the borrower has the loan balance of at least US$15 million on the date of utilisation; or, most notably, if the borrower is a Turkish special purpose vehicle that is incorporated solely to purchase the shares of a company. The form of the special purpose vehicles (i.e., whether these companies should be incorporated as holding companies) is yet to be clarified.

Furthermore, a Turkish resident must notify any guarantee it provides abroad to the Ministry of Treasury and Finance of the Republic of Turkey within 30 days of the signing date. The purpose of this rule is to enable the Turkish Central Bank and the Turkish Treasury to keep records of loans and securities (statistical tracking) and to prevent any breaches of money-laundering regulations.

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5 Loan balance is defined as the total of the unpaid foreign currency loans obtained from the banks located in Turkey and abroad.
According to the Turkish regulations on money laundering and financing of terrorism, Turkish banks (banks licensed in Turkey) are further required to immediately inform the Turkish Financial Crimes Investigation Board about suspicious transactions (transactions that may relate to illegal purposes such as financing of terrorism). In this context, unusually excessive money transfers shall be considered suspicious and therefore notified to the Turkish Financial Crimes Investigation Board.

As mentioned above, Turkish resident legal entities may obtain loans from banks or financial institutions resident abroad subject to limitations explained above. Additionally, according to a prohibition that was adopted in 2014, Turkish residents are prohibited from obtaining revolving loans from lenders resident abroad.

### ii Tax matters

**Resource Utilisation Support Fund**

The Resource Utilisation Support Fund (RUSF) applies to Turkish lira-dominated loans obtained by Turkish residents (except for banks and financing companies) from abroad at a rate of 1 per cent for loans with an average maturity up to one year. The RUSF does not apply to such Turkish lira-dominated loans obtained from abroad with an average maturity of one year and more. For foreign currency denominated loans, the rate varies between zero per cent and 3 per cent.

The RUSF does not apply to loans obtained from Turkish banks.

**Banking and insurance transaction tax**

Five per cent banking and insurance transaction tax (BITT) is applicable over the interest payment of loans obtained from Turkish banks, which is deductible for Turkish corporate tax purposes. The BITT is not applicable to loans obtained from abroad.

**Reverse charge VAT**

If a Turkish company obtain loans from a foreign entity other than a financial institution or bank (e.g., an intragroup loan), the interest payment is subject to reverse charge VAT at a rate of 18 per cent.

**Withholding tax**

Withholding tax is not applicable to interest payments paid for loans obtained from banks, international institutions and financial corporations, while it is applicable at a rate of 10 per cent to interest payments regarding the loans obtained from non-financial corporations.

**Thin capitalisation rules**

Thin capitalisation rules are only applicable to related party transactions. If the debt financing obtained from shareholders or related parties of the shareholders exceeds the shareholders’ equity in the borrower company threefold, it will be considered as thin capital, and the following thin capitalisation rules will apply:

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6 A related party of the shareholders is (1) a corporation in which the shareholder owns, directly or indirectly, more than 10 per cent of the shares, voting rights or rights to receive dividends; or (2) a corporation or individual that owns, directly or indirectly, at least 10 per cent of the capital, voting rights or rights to receive dividends of the shareholder or an affiliated corporation of a shareholder.
financing expenses such as interest accruals and foreign exchange costs corresponding to the exceeding portion of the acquisition financing cannot be deducted for corporate tax purposes; and

interest paid or accrued on the thin capital will be deemed dividends received by the lender and will be subject to withholding tax.

III SECURITY AND GUARANTEES

i Collateral

In Turkey, common types of collateral used in acquisition financing are:

- pledge over shares;
- pledge over real property;
- surety;
- guarantee;
- pledge over movables;
- pledge over bank accounts; and
- assignment of receivables.

Pledge over shares and pledge over real property are the collateral types that are most commonly obtained by the lenders. In Turkish practice, depending on the borrower’s field of activity and asset portfolio, the lenders require the borrower to provide a security package including all or some of the above-mentioned collateral.

A hot topic under Turkish law is the lenders’ tendency to request a guarantee as collateral instead of a surety. A surety agreement imposes a secondary obligation on the surety while a guarantee agreement imposes a primary obligation on the guarantor independent from the validity of the underlying receivable. A surety can raise its own defences against the lender, such as lack of a qualified form requirement, or the invalidity of the underlying agreement or statute of limitation related to the underlying agreement. On the other hand, the receivables arising from the guarantee agreement, similar to the bank letter of guarantee, must be paid upon the lender’s first request without the need for any further review. Given the foregoing, the guarantee agreement provides a stronger protection to lenders.

Guarantee agreements are not specifically governed under Turkish law. Turkish scholars often interpret the guarantee agreement within the scope of ‘guarantee of performance by third party’ under the Turkish Code of Obligations. Therefore, rules applied to guarantee agreements as well as the distinguishing criteria of the guarantee agreement and the surety agreement are mainly determined by scholars and court precedents. There is often confusion about the nature of the agreement (i.e., whether it is a guarantee or a surety) that may be brought to courts.

As for the collateral commonly used in Turkish acquisition financing market, a recent development is the change in legislation regarding the pledge over movables. The Law on Pledges over Movable Assets in Commercial Transactions has been effective since 1 January 2017; its aim is to popularise the use of movable pledge rights as collateral, to extend the scope of movables subject to the pledge, to ensure public accessibility and transparency in movable pledges and to facilitate easy access to financing by way of new alternatives in foreclosure of the pledged property. The Movable Pledge Registry was established as a new registry for pledged movables for the registration of the relevant pledge agreement to establish a pledge over movables. Movable Pledge Registry transactions are made via an online system and registered by the notary public.
With the enactment of the Law on Pledge over Movable Assets in Commercial Transactions, the Law on Commercial Enterprise Pledge, which has been in force since 1971, was abolished. Now, in addition to banks and credit institutions, small-sized enterprises can establish a commercial enterprise pledge. Contrary to the Law on Commercial Enterprise Pledge, a pledge over one or more movable assets may be established. As a particularly special exception (introduced by the new law), a pledge may be established on the entire commercial enterprise only if those movable assets are not sufficient to pay off the debt.

The pledge can be established on movables including receivables; intellectual and industrial property rights; raw materials; animals; any income and revenues; any licences or permits for which registration is not required; rental incomes; tenancy rights; trade names or business names; and other movables set out under the new law. The new law imposes stricter obligations on the pledgee, and its pledge rights are restricted (e.g., establishment of a pledge over the entire enterprise is not possible if the assets subject to pledge provide sufficient collateral against the facility amount). The new law also allows the pledgor to request the transfer of the pledged movables’ ownership upon default; this is an exemption from the general principle of Turkish pledge law prohibiting lex commissoria.

ii  Financial assistance prohibition

According to Article 380 of Turkish Commercial Code No. 6102 (TCC), which entered into force on 1 July 2012, a company cannot advance funds, or provide loans, security or guarantee, to a third party with a view to facilitate the acquisition of its own shares. Any such finance transaction is prohibited and is considered null and void. The TCC has enabled companies to buy back their shares or to accept as pledge up to a limit of 10 per cent of the share capital, but has also introduced the financial assistance restriction. Accordingly, in the Turkish M&A market, one of the common matters that investors look for an answer to is whether any kind of collateral granted by the target company falls within the scope of the financial assistance prohibition.

Any type of transaction aiming to provide financial assistance for the acquisition is within the scope of the prohibition (e.g., advancing funds, providing loans, security or guarantee to a third party). Transactions are not exhaustively listed and any direct or indirect attempt to facilitate the acquisition may fall within the scope of the prohibition. There are certain exceptions to the prohibition:

a  transactions carried out by banks and financial institutions in performance of their ordinary course of business; and
b  acquisition of shares by the company’s employees or its affiliated companies’ employees.


Financial assistance in Turkey has been subject to various discussions and criticism among scholars and legal practitioners. The main point of criticism is that the legislator did not take the liberalisation brought by the 2006 Directive into consideration, leaving Turkey behind the development of company law in Europe.
iii Prohibition to exercise abusive control over subsidiaries

Intragroup guarantees are commonly used in acquisition finance. According to Article 202 of the TCC, in a group of companies, a dominant company cannot exercise its dominance in a manner that results in a loss to its subsidiary through transactions such as the transfer of funds and the provision of guarantees. If a dominant company forces a subsidiary to participate in a transaction that is likely to result in a loss, the dominant company must compensate this loss during the year in which it occurred; or grant the subsidiary a right of claim equal to the amount of loss incurred.

In addition, according to Articles 203–206 of the TCC, in the event of full control (100 per cent), the dominant company may give instructions regarding the management of the controlled entity, even if this may cause losses. However, creditors may claim the responsibility of the parent company and its board in the case of damages.

The above provisions of the TCC allow transactions that constitute financial assistance in a group of companies, subject to certain conditions, for example, compensation of loss. In other words, the TCC provides for a consolidated liability regime for groups of companies instead of the general rules for capital maintenance. Therefore, although not explicitly stated under Turkish law, it is widely accepted among the Turkish scholars that financial assistance in a group of companies does not fall within the scope of the financial assistance prohibition set forth under Article 380 of the TCC.

iv Securities granted before the commencement of insolvency proceedings

According to Article 279 of Execution and Bankruptcy Law No. 2004 (EBL), certain transactions of the debtor including the establishment of a pledge to secure an existing debt are subject to annulment if they are exercised within a one-year period prior to the commencement of insolvency proceedings.

In addition, Article 280 of the EBL provides that if a debtor whose assets do not suffice to satisfy its debts enters into any transaction with the intention of damaging its creditors’ rights, the creditors may request the court to annul the debtor’s transaction, provided that the creditors initiate an insolvency proceeding against the debtor within five years of the date of the relevant transaction.

v Security agent

The concept of a security agent is not specifically governed under Turkish law. However, in Turkish practice and particularly in foreign law-governed acquisition finance transactions involving several lenders, a security agent is commonly used to simplify the security establishment and enforcement. The common view in the Turkish market is that the concept of a security trustee or agent would be recognised under Turkish law. However, there is no court precedent as to whether such provisions are enforceable under Turkish law.

IV PRIORITY OF CLAIMS

i General rules on priority of claims

Under Turkish law, the general rule is that creditors secured with pledges over the debtor’s assets have priority at the distribution of the proceeds to be generated through the sale of those pledged assets. After the public receivables including the taxes and the sale costs regarding the pledged asset are paid, first the secured creditors and then the unsecured creditors are satisfied. The unsecured creditors’ claims are ranked as follows:
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a employment receivables;
b receivables related to family law;
c privileged creditors’ receivables governed under the relevant laws (e.g., receivables of the Central Bank of the Republic of Turkey and receivables of the Social Security Institution of the Republic of Turkey); and
d other unsecured creditors’ receivables.

ii Ranking system

As for pledges over immovables, the ranking system adopted under Turkish law provides a priority ranking to mortgagees holding a mortgage with a preceding degree over other mortgagees in subsequent rankings. The degrees of mortgages on real property separately secure the obligations for which they are created up to the mortgage amount in each degree. The degree determines the order of distribution of the foreclosure proceeds. Accordingly, unless the first-degree mortgagee is fully satisfied, a second-degree mortgagee cannot be satisfied with the proceeds of the foreclosure.

As for pledges over movables, the priority regime was changed by the Law on Pledges over Movable Assets in Commercial Transactions that has been effective since 1 January 2017. Previously, creditors’ rights were ranked in accordance with the date they established the pledge. Now, the security provided by the pledge will be limited to the amount and the pledge’s degree as registered with the relevant registry. The date of establishment is considered by determining the priority only if the parties did not agree on the pledge’s degree.

iii Subordination agreements

Subordination agreements are commonly used in Turkish practice. However, Turkish law does not govern contractual subordination. Therefore, such agreements are not enforceable by the public authorities during an execution or bankruptcy proceeding. Under Turkish law, the priority of claims is determined by the EBL without taking into consideration any subordination agreement. Thus, a subordination agreement only creates a contractual obligation and is binding on the creditors that are party to the agreement.

V JURISDICTION

i Choice of foreign law

Under Turkish law, parties are free to choose a foreign law to govern their contract. The right to choose a foreign law to govern a contract is expressly provided for in the International Private and Procedure Law (IPPL), particularly in the presence of a foreign element. According to the IPPL, where there is (1) a foreign element and (2) an express choice of law to govern, the contract will be recognised and applied by the Turkish courts in any action.

However, the overriding mandatory provisions of Turkish law are applicable to any situation falling within their scope, irrespective of the foreign governing law. These provisions are those that are regarded as crucial by Turkish law for safeguarding public interests, such as the political and social organisation of the state. In addition, the provisions of the governing law chosen by the parties cannot apply if the provision of the applicable foreign law is expressly contrary to Turkish public policy.
ii Choice of foreign court’s jurisdiction and enforcement

The IPPL also governs the agreement on jurisdiction of a foreign court. The IPPL states that the consent of the parties to the exclusive jurisdiction of a foreign court is valid and binding if:

a. the dispute between the parties contains a foreign element;

b. the dispute arises from a debtor–creditor relation; and

c. the matter of the dispute is not within the exclusive jurisdiction of the Turkish courts.

In addition to these conditions:

a. the agreement must be in written form and as per the precedent of the Court of Appeals; and

b. the dispute subject to the exclusive jurisdiction of the foreign court and the court chosen by the parties as the competent court must be unambiguous.

In practice, there is also a Turkish court precedent that requires the foreign court selection to be ‘very clear’. Turkish practice has developed in a manner requiring the parties to specify the city, state (if applicable) and country of the courts in question. For instance, the jurisdiction clause must not refer to the English courts in general but to London courts or other courts in other cities. It is worth emphasising that, as per the precedent of the Court of Appeal, a jurisdiction clause granting jurisdiction to the ‘English courts’ without mentioning the specific city or province is not valid as the court is not definite.

The IPPL applies to the enforcement of foreign court judgments in Turkey. Under the IPPL, the grounds for a Turkish court to decide to enforce a foreign court judgment are as follows:

a. the foreign court judgment must be final and binding, with no recourse to appeal or similar review process under the laws of the relevant country;

b. there must be de jure or de facto reciprocity between Turkey and the country of the relevant foreign court. If there is no such agreement, then the Turkish court hearing the enforcement lawsuit would seek confirmation of de facto reciprocity;

c. the subject matter of the judgment must not fall under the exclusive jurisdiction of Turkish courts or – subject to the defendant having raised an objection in this regard – the judgment must not have been rendered by a court that found itself competent to resolve the dispute, although it has, in fact, no relation to the subject matter of the dispute or to the parties;

d. the decision must not be in clear conflict with Turkish public policy; and

e. the party against whom enforcement of the judgment is sought must have been duly served or must have been made fully aware of the proceedings and given the full opportunity to represent or defend himself or herself in the legal proceedings in relevant jurisdiction.

iii Arbitration and awards

In Turkey, the use of international arbitration has substantially increased since the early 2000s. Changes in legislation that led to relatively more certainty regarding arbitral awards’ enforcement as well as increased foreign direct investments in Turkey with the choice of arbitration in their contracts have resulted in such increase. The Istanbul Arbitration Centre started operating in October 2015. This significant development is expected to result in that arbitration being even more commonly used.
The primary Turkish legislation governing international arbitration is International Arbitration Law No. 4686 (IAL), which is applicable if the venue of arbitration is in Turkey and the dispute contains a foreign element. Under the IAL, validity and enforceability of an arbitration agreement are governed by the law that the parties chose as the governing law, or by Turkish law if there is no specific choice of law applicable to the arbitration agreement. For an arbitration agreement to be valid and enforceable under Turkish law:

- the parties’ intention to arbitrate must be clear and unambiguous;
- the arbitration agreement must define the relevant legal relationship;
- the parties must have the capacity to sign an arbitration agreement under the law applicable to their capacity; and
- the arbitration agreement must be in writing.

If the Turkish court finds that the dispute’s subject matter is not arbitrable under Turkish law, an arbitral award may be set aside. Disputes relating to rights in rem over real property in Turkey and disputes that are not at the parties’ free disposal are not arbitrable. Disputes relating to family law, consumer law and labour law, bankruptcy lawsuits, and disputes subject to the jurisdiction of criminal courts and administrative courts may not be submitted to arbitration.

The IAL does not govern enforcement of foreign arbitral awards. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) is the principal source for the recognition and enforcement of foreign arbitral awards in Turkey. The relevant provisions of the IPPL also apply to issues where the New York Convention is silent.

There is no significant difference between the conditions for enforcement of foreign court judgments and foreign arbitral awards. Retrial or examination of a case’s merits is prohibited for the enforcement of both. However, the condition of reciprocity explained above is not sought for the enforcement of foreign arbitral awards, while it is used for the enforcement of foreign court judgments.

VI ACQUISITIONS OF PUBLIC COMPANIES

Public companies in Turkey are subject to supervision of the Turkish Capital Markets Board (CMB) and certain requirements, including public disclosure, mandatory tender offer, and squeeze-out and sell-out rights under the Turkish capital market laws.

i Public disclosure

Under the capital markets regulations, the companies must disclose certain material information to the public through online platforms, for example, changes in the share capital or management control of the company. Any acquisition of a listed company must also be disclosed to the public by the bidder. This can be carried out before or after the acquisition depending on the turnovers and significance of the transactions on the investors.

ii Tender offers

Tender offers are regulated by the Communiqué on Tender Offers (II.26-1). If a person or group of persons acting in concert, directly or indirectly, acquires shares granting management control over a public company, such person or persons must make a tender offer to the other shareholders for the target company’s remaining shares under the terms and
conditions approved by the CMB. Under the Communiqué on Tender Offers, a mandatory tender offer is triggered by ‘acquisition of management control’, which is defined as the acquisition – whether directly or indirectly, single-handedly or together with others acting in concert – of shares representing at least 50 per cent of the voting rights; or, regardless of share percentage, privileged shares entitling the holder to appoint or nominate the majority of the board of directors. According to a recently adopted amendment, the CMB may hold the banks exempt from making a mandatory tender offer at the time of acquiring the shares that were pledged to the bank as a security upon the borrower’s default in the underlying loan and at the time of transfer of these shares from the bank or a special purpose vehicle owned by the bank to a third party.

In addition to the mandatory tender offers, the Tender Offer Communiqué also regulates the voluntary tender offer process. A voluntary tender offer can be launched for the acquisition of all or part of a public company’s shares. However, if a partial voluntary tender offer results in the acquisition of management control over the target, the offeror must make a mandatory tender offer for the target’s remaining shares. On the other hand, if management control is acquired following a voluntary tender offer made for all shares in the public company, a mandatory tender offer is not required.

iii Squeeze-out and sell-out rights
Squeeze-outs in public companies are regulated by the Communiqué on Squeeze-out and Sell-out Rights (II-27.2). The Communiqué regulates the squeeze-out of minority shareholders by the majority shareholder, as well as the minority shareholders’ exit right by selling their shares to the majority shareholder in public companies. If the total voting percentage of a shareholder or group of shareholders acting jointly reaches or exceeds 98 per cent or more in a public company, such shareholder or group of shareholders is deemed to be the ‘controlling shareholder’. The controlling shareholder can reach the threshold by way of different methods such as a tender offer, merger, capital increase or otherwise. When the controlling shareholder reaches this threshold, minority shareholders can exercise their exit right and force the controlling shareholder to purchase their shares. The minority shareholders must apply to the company within three months following the public disclosure stating that the controlling shareholder has reached or exceeded the mentioned threshold. If the minority shareholders fail to apply to the company within such period, their exit right is terminated, and the controlling shareholder can exercise the squeeze-out right and force minority shareholders to exit the company by applying to the company within three business days following the end of the three-month period.

VII THE YEAR IN REVIEW
In 2018, early presidential elections, political crises and currency fluctuations affected Turkish markets in every aspect. Following the elections in July 2018, the national state of emergency that has been in effect since the attempted coup d’état of 2016 has been abolished. Although the market has shown a slight recovery in comparison to the previous years, factoring in the socioeconomic conditions, a full recovery is expected to take some more time. In 2019, the renewal of Istanbul municipal elections and shifting political winds have influenced the markets deeply and demonstrated the longing for stability and growth in Turkey. With no new elections on the horizon for four years, Turkish markets’ focus may shift towards economic progress.
Other than the major changes to foreign borrowing limitations, new developments in the data protection area have kept companies busy from a compliance perspective. The Personal Data Protection Board’s data controllers’ registry started to accept registrations in early 2019.

Another vital development in 2018 related to bankruptcy procedures; the suspension of bankruptcy procedure has been eliminated with the amendments to the EBL, leaving debtors with the only viable option of moratorium to avoid bankruptcy. With the ‘zoning peace’ of 2018, the owners of the unregistered immovables were able to receive a temporary permit and commence the procedures to register their movables with reduced fines. In 2019, mandatory mediation in commercial disputes have been introduced and Turkey’s execution of the United Nations Convention on International Settlement Agreements Resulting from Mediation (the Singapore Convention) was another development in the legal framework environment.

The cause célèbre of 2018 was the application by Akbank, Garanti Bankası and İş Bankası to the Turkish Competition Board for the acquisition of a 55 per cent stake in Türk Telekom, held by Otaş, to a bank-owned special purpose vehicle owing to the default of Otaş in June 2018, with a transaction value of US$5.1 billion. Acquiring banks have financed the leveraged buyout of Türk Telekom, previously the state-owned telecommunications giant of Turkey, by Otaş for US$4.75 billion in 2013. Another notable deal that was finalised in 2019 was the acquisition of the majority shares of Denizbank by Emirates NBD Bank from Sberbank for US$3.2 billion. Following the privatisation of 13 sugar production factories in 2018, the privatisation of Milli Piyango (the Turkish national lottery) is expected to be finalised in 2019 for approximately US$1.6 billion; the Demirören Group–Sisal SpA joint venture won the tender in early 2019. Furthermore, the acquisition of a majority stake at iyzico by Naspers Group for US$165 million, the acquisition of Temsa by True Value Capital Partners, the acquisition of EWE Group’s Turkish subsidiaries Millenicom, Kayserigaz and Bursagaz by SOCAR, and the acquisition of Ergo Sigorta by HDI Group were other noteworthy deals.

VIII OUTLOOK

Small-to-medium-sized companies that are in financial distress and companies without any export capabilities will struggle with foreign exchange exposure, considering a potential local or global economic recession. On the other hand, businesses with export operations will be the focus of investors’ attention. Finally, the expected sales of certain assets and companies from the portfolio of the Savings Deposits and Insurance Fund may boost activity in the Turkish M&A market.

Forecasts for 2019 are mainly dogged by Turkey’s growth uncertainty, the fluctuations of the Turkish lira against foreign currencies and high inflation. We expect the 2019 deal volume to be similar to 2018. Despite all the political and economic turmoil, the Turkish market continues to have great potential and investors who are familiar with the region and have long-term investment plans will not be reluctant to continue investing in Turkey.

7 www.ntv.com.tr/ekonomi/turk-telekomda-yonetim-bankalara-geciyor-otas-kredi-borcu-nedeniyle,2rU2eqWiN0C0lu1CV86UBg.
Chapter 19

UNITED KINGDOM

Suhrud Mehta, Russell Jacobs, Mark Stamp, Mitali Ganguly and Francesca Mosely

I OVERVIEW

The leveraged finance market in England and Wales is a mature, sophisticated and developed one. Alongside New York, London is one of the key financial centres globally, and as such a huge volume of finance and leveraged finance transactions are conducted here.

Financing sources in the London market are diverse and include banks, funds, CLOs, institutional investors both domestic and international. The relatively stable political and legal framework in England and Wales lends itself to being a hub for pan-European and international finance transactions originated and executed out of London (the decision to withdraw the United Kingdom from the European Union (Brexit) notwithstanding).

Leveraged finance transactions can be and are funded through a variety of different instruments. Syndicated loans, high-yield bonds (senior secured or senior subordinated/unsecured), direct lending or unitranche facilities (provided by specialist credit funds), PIK facilities, preferred equity, first lien, second lien and more besides.

II REGULATORY AND TAX MATTERS

i Regulatory

The Financial Conduct Authority and the Bank of England Prudential Regulatory Authority oversee the financial services industry in England and Wales. Certain licences and approvals are required in relation to certain regulated activities but these are not applicable to providing loans to, or subscribing for debt instruments issued by, entities incorporated or formed in England and Wales that are not individuals and that do not relate to certain residential real estate arrangements. Therefore, bank and non-bank institutions or funds may lend to such entities or participate in ordinary course finance transactions without impediment from regulatory constraint. It is worth noting, however, that borrowers or issuers that are themselves regulated businesses (such as financial services firms or businesses that provide insurance services) will have to comply with the terms of their own approvals and licences under which they operate, which can impact on the scope of guarantees and security that they are able to provide to their financiers.

In May 2017, the European Central Bank (ECB) published its Guidance on Leveraged Transactions (the ECB Guidance), which came into force in November 2017. This is the European counterpart to the Interagency Guidance on Leveraged Lending (the US

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1 Suhrud Mehta, Russell Jacobs and Mark Stamp are partners and Mitali Ganguly and Francesca Mosely are associates at Milbank LLP. The information in this chapter was accurate as at November 2018.
Guidance). While the US Guidance applies to all federally regulated financial institutions (including US branch of non-US banks and some non-bank lenders), the ECB Guidance only applies to significant credit institutions supervised by the ECB under Article 6(4) of the SSM Regulation. English credit institutions are not supervised by the ECB under the SSM Regulation and are, therefore, outside the scope of the ECB Guidance, albeit their Eurozone branches would be (currently at least; Brexit may impact this).

While the ECB Guidance largely follows the principles of the US Guidance, there are certain crucial distinctions between the two, such as what is considered a ‘leveraged transaction’ (both regimes have a ‘leverage test’ with varying degrees of specificity, whereas the ECB Guidance also has a ‘sponsor test’ that captures all types of loan or credit exposure if one (or more) financial sponsors controls or owns more than 50 per cent of a borrower’s equity, for which there is no equivalent in the US Guidance) and what transactions are exempted: the ECB Guidance provides exemptions for all loans to natural persons, credit institutions, investment firms, public sector entities and financial sector entities, trade finance and loans to investment-grade borrowers, but no such exemptions exist under the US Guidance.

While the purpose of the ECB Guidance is to increase scrutiny of (and presumably reduce the prevalence of) leveraged transactions, the ECB Guidance is for the moment non-binding, and the results in practice of them being in place remain to be seen. At the time of writing, the ECB intends to submit an internal audit report to the joint supervisory team in November 2018 detailing how the ECB Guidance has been implemented in the procedures of the relevant credit institutions. It is possible this report will lead to further developments in this area in the coming months.

Finally, it is worth noting that England and Wales does have anti-money laundering, anti-bribery and sanction-related legislation and regulations that borrowers will be routinely required to comply with by the terms of their financing arrangements.

ii Tax

There are three main areas where tax needs to be considered: first, withholding tax on interest (whether to creditors on the loan in question or on intragroup loans that service the external debt); second, deductibility of interest and other equivalent funding costs for the borrower, coupled with the resultant utilisation of these costs for tax purposes; and third, tax issues that commonly arise on enforcement of security.

The United Kingdom imposes withholding tax (currently at the rate of 20 per cent) on payments of interest (cf. discount) that have a UK source; however, a number of exemptions are available to eliminate or reduce this withholding tax.

First, UK banks (UK-incorporated or UK branches of foreign banks) and UK corporate lenders that are taxed on the interest in the UK may receive interest gross.

Second, non-UK lenders that are suitably resident in treaty-protected jurisdictions (normally excluding tax havens) can normally reduce or eliminate withholding tax. The UK has a comprehensive network of bilateral tax treaties.

Third, under the ‘private placement’ exemption, interest on unlisted debt securities and syndicated loans is exempted from withholding tax.

Note that these first three exemptions depend (among other things) on the characteristics (e.g., treaty residence and tax-paying status) of the lender; and double tax treaty benefits and eligibility under the private placement exemption require the submission of proof of such. Treaty ‘passports’ are available for many institutional treaty-protected lenders, which streamlines what can otherwise be a lengthy and bureaucratic credit rebate process.
Fourth, the ‘quoted eurobond’ exemption applies to interest-bearing debt that is publicly listed on a recognised stock exchange regardless of the identity of the beneficial owner of the interest (contrast the prior exemptions). Note that, in addition to the formal requirements underpinning the listing, only a public limited company may issue publicly listed securities.

The breadth of these exemptions provides a fiscal platform that is highly facilitative to the raising of funds by UK borrowers from a wide range of lenders and non-banking investors (including offshore funds – especially, in light of the quoted eurobond exemption those based in tax havens such as the Cayman Islands or Channel Island) or those who, although resident in a taxing jurisdiction, cannot avail themselves of a full exemption from the UK source withholding tax.

At the time of writing, with Brexit looming, it is not thought that, in itself, Brexit will have an adverse impact on the nature or breadth of these exemptions; but it is an area to keep under review.

Finally, of equal importance is the question of ensuring that the UK borrower that on-lends loan proceeds (or is itself a group creditor on intragroup loans that directly or indirectly service the external debt can receive corresponding interest from its internal borrowers free of source withholding imposed by the latter’s jurisdictions). At present, the UK enjoys a network of favourable double tax treaties, and, under current EU legislation the Interest and Royalties Directive and (for debt service via intragroup dividends) the Parent-Subsidiary Directive. Brexit may well have an impact on this latter benefit.

Interest (including discount and other revenue funding costs) is normally tax-deductible when computing the borrower’s taxable profits. As a general proposition, tax follows the accounts so that the borrower’s debt service costs as per the accounts will form the starting point for the tax deductions. However, the UK’s tax regime contains a number of complex rules that can limit the deductibility of interest (and also limit the extent to which unutilised tax-deductible interest costs can be carried forward for use in future accounting periods). These detailed rules are beyond the scope of this chapter, but a few basic concepts should be kept in mind.

First, as a result of the OECD’s recommendations under its Base Erosion and Profit Shifting (BEPS) project, the UK, in common with most OECD members, has introduced a basic interest limitation rule that limits a UK company’s deductible interest expenses to 30 per cent of its EBITDA (adjusted for certain tax-related amounts). There is a more complicated limitation ratio that applies to groups, but the detail is beyond the scope of this chapter.

Second, arm’s-length transfer pricing rules apply, as generally within the OECD community, particularly to related party borrowing arrangements. This is especially important where intragroup (or related equity investor) funding arrangements apply to either the external debt or, more likely, to internal (or ‘pushed-down’) debt that services the external borrowings.

Third, and importantly when assessing the debt capacity of a UK group in a leveraged acquisition or refinancing scenario, the UK restricts (to 50 per cent in most cases, subject to a £5 million per annum de minimis group threshold allowance) the amount of profits against which carried-forward losses (including interest costs) can be relieved. These rules are very complex and will invariably need to be factored into any UK group tax finance cash flow model when the debt capacity is being engineered at the outset of the transaction.

One final tax issue to be aware of when structuring a leveraged financing is the tax consequence of enforcing security on a UK group of companies. The UK permits
tax consolidation within a corporate group; this allows UK group members to surrender losses, and reallocate gains, between each member on a current year basis. This group tax optimisation thus allows deductible interest expense in one UK company to be offset against income of another group member: so the borrowing need not be incurred in the tax-profitable company. This allows, among other things, for debt to be structurally subordinated without jeopardising the tax efficiency of the overall arrangements. Furthermore, the tax grouping rules allow assets to be transferred intragroup on a tax-neutral basis. However, the group relationship will be broken upon enforcement of third party lender security such as share pledges over group company debtors where security is enforced at a level below the tax parent (thus preventing future loss offset) and enforcement-triggered degrouping charges can be crystallised where latent capital gains are recognised in respect of pre-enforcement intragroup transfers of capital assets. Thus, when assessing the impact of a complex security package, the tax effect of enforcement against companies inside or outside the security field needs to be carefully considered.

III SECURITY AND GUARANTEES

Taking guarantees and security from companies incorporated in England and Wales is usually very straightforward and free from significant limitations and formalities.

Guarantees must be in writing (as required by Section 4 of the Statute of Frauds 1677) and provided in return for consideration or executed as a deed. Otherwise downstream, upstream and cross-stream guarantees are routinely given in financings involving English companies. Under English law, the directors of English companies owe duties to the company for which they are director. Many of these duties have been codified now in the Companies Act 2006 (CA 2006). In particular, Section 172 of the CA 2006 provides that each director must act in a way that ‘would be most likely to promote the success of the company for the benefit of its members as a whole’, that is, in the best interests of the company. In practice these considerations in the context of providing guarantees (and security) to support financing incurred to acquire a new business for the purpose of generating value for shareholders will rarely if ever be an issue.

Security packages will typically include all assets since it is straightforward for a company to grant security interests over all assets in one overarching security agreement or what is sometimes referred to as a debenture. Certain steps will need to be taken in order to perfect, protect or assist with any future enforcement. The most important is registration at Companies House, which must be carried out within 21 days of execution otherwise the security interests will be void. The registration process is quick (it can be done online), cheap and easy. Other steps may include registration at certain asset-specific registries (real property, intellectual property, aircraft and ships), the giving of notices to contract counterparties or account banks and the delivery of share certificates and executed blank stock transfer forms.

A key feature of any English law security agreement or debenture may be a floating charge that covers all or substantially all of the assets of a company. This will, therefore, constitute a ‘qualifying floating charge’ for the purposes of Paragraph 14 of Schedule B1 to the Insolvency Act 1986, meaning that the beneficiary thereof can appoint its own administrator that can take control of the affairs of the company in order to act in the interests of the company’s creditors in a restructuring situation.

Security in English law finance transactions will typically be granted in favour of a security agent or trustee that will hold the benefit of the security on trust for the lenders as
a group. Therefore, there are no issues with transferring debt between lenders as the security will continue to be held for the benefit of the class of lenders identified as beneficiaries of the trust from time to time.

As noted below, financial assistance rules do exist, meaning that UK public companies (and their direct and indirect subsidiaries) are prohibited from providing ‘financial assistance’ (which would include providing guarantees or security, or both) in connection with the acquisition of shares in that public company. Any transaction entered into in breach of the financial assistance restrictions would be void and unenforceable. It is typical to reregister a public company post acquisition as a private company in order to permit financial assistance to be granted.

There are also restrictions as to distributions and capital maintenance in the CA 2006 which mean that a company can only make distributions to the extent that they are made from distributable profits. There has been some debate and concern that providing a guarantee in respect of a shareholders obligation may constitute a distribution and therefore could be unlawful if there were insufficient distributable profits to cover the amount of the guarantee. However, the generally held view is that unless the company concludes that the guarantee will inevitably be called (or is likely to be called) then the guarantee ought not to be viewed as a distribution.

There are a number of categories of potentially vulnerable transactions that could be investigated by an administrator or liquidator and, if the relevant conditions met, set aside. Vulnerability periods range between six and 12 months depending on the nature of the transaction and the relationship between the company and the relevant creditor or creditors. Key headings of vulnerable transaction are: transactions at undervalue, preferences, defrauding creditors, extortionate credit transactions and avoidance of floating charges. For a transaction to be set aside under any of these headings, the relevant company generally (although not in all cases) has to have been insolvent at the time, or became insolvent as a result, of the relevant transaction. There are also other potential safe harbours (as well as the passage of time), so in the context of an ordinary course bona fide financing transaction these considerations ought not cause any issues in practice.

IV PRIORITY OF CLAIMS

In an insolvency, creditors will be paid in the following order:

a fixed charge holders: Fixed charge holders will be paid from the proceeds of realisation in respect of any assets over which a fixed charge has been granted. Fixed charges (as opposed to floating charges) are loosely speaking, security interests which provide a degree of control over what the chargor can do with the assets. If the chargor can freely dispose of assets it is likely that (even if it is called a fixed charge) the charge over it will be classified as a floating charge and the priority on insolvency will be affected accordingly;

b liquidator and administrator expenses;

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2 Section 238 of the Insolvency Act 1986.
3 Section 239 of the Insolvency Act 1986.
4 Section 423 of the Insolvency Act 1986.
5 Section 244 of the Insolvency Act 1986.
preferential creditors (i.e., employees with unpaid wage claims, unpaid contributions to pension schemes);

floating charge holders: Floating charge holders will be paid from the proceeds of realisation in respect of any assets over which a floating charge has been granted, subject to a certain portion of those proceeds called the ‘prescribed part’ that is reserved for unsecured creditors. The prescribed part is calculated as a percentage of the floating charge proceeds and is capped (at the moment) at £600,000; and

unsecured creditors: This includes trade and other creditors and creditors that had security but whose claims exceed the proceeds realised from the assets that were subject to their security.

Equitable subordination is not a feature of English law. Contractual subordination is routinely utilised in English law intercreditor agreements to regulate claims amongst third party creditors but also to subordinate the claims of intragroup or shareholder lenders to the claims of external third party creditors. It is a fundamental principle of English law that creditors in an insolvency must be treated on an equal basis such that distributions are made to creditors pari passu. Notwithstanding this, however, certain cases have established that contractual subordination does not offend this principle.

V  JURISDICTION

The basic rule under English law (now EC Regulation 593/2008 – ‘Rome I’, subject to certain common law rules that still apply in certain cases) is that a choice of English law (or the law of some other jurisdiction) as the governing law of a contract or part of a contract will be effective. Although the parties’ choice of law may, in a limited number of cases, be ineffective or overridden, it is worth noting that in the context of complex cross-border transactions involving a number of finance parties from different jurisdictions, the relevant provisions of Rome I are very unlikely to operate to override the parties’ choice of English law as the governing law of any of their contracts.

However, common law rules may still be relevant as Rome I does not automatically apply to all contracts. In particular, it does not apply to arbitration agreements, trusts, certain insurance contracts and negotiable instruments, nor does it affect issues relating to companies and their capacity, or the ability of agents to bind a principal. Where Rome I does not apply to a particular contract, the ordinary common law rules on choice of law under English common law is that an express choice of English law as the governing law of a contract will be effective unless the choice is not ‘bona fide and legal’ or is contrary to public policy. This rather vague formulation is in fact very narrow in its application as there are few circumstances that can be envisaged where a choice of governing law is not bona fide.

The granting of exclusive jurisdiction to English courts in respect of any disputes that may arise will be given effect to in accordance with Article 25(1) of EU Regulation 1215/2012 (the Brussels I Regulation (recast)). It is common to provide for ‘exclusive’ jurisdiction even though Article 25(1) of EU Regulation 1215/2012 provides that if the parties provide for courts to have jurisdiction then that jurisdiction will be treated as being exclusive unless the parties have agreed otherwise. Non-exclusive jurisdiction clauses ought to be avoided since

7 Contracts entered into before 17 December 2009 are governed by the Rome Convention of 1980 (incorporated into the Contracts (Applicable Law) Act 1990), which is beyond the scope of this chapter.
an English court will be obliged to stay proceedings before it if proceedings involving the same cause of action and between the same parties have already been brought in the courts of another member state of the European Union and may stay its proceedings in certain other circumstances.

English courts will generally recognise and enforce foreign judgments. The precise rules and limitations, however, will depend on the jurisdiction of the courts that have issued the relevant judgment. European regulations and conventions, domestic legislation or common law rules may apply.

VI ACQUISITIONS OF PUBLIC COMPANIES

When funding acquisitions of public companies in the United Kingdom, there are additional issues and considerations for lenders to those faced when funding private companies, in particular the issues that arise from the requirements of the City Code on Takeovers and Mergers (the Code) and the provisions of the CA 2006 relating to financial assistance and the compulsory acquisition of shares following a successful offer.

i The Code

Broadly speaking, the acquisition of any (1) public limited company, (2) private company previously listed in the past 10 years or (3) societas Europaea, in each case that has its registered office in the United Kingdom, Jersey, Guernsey or the Isle of Man and is either listed in any of those jurisdictions or has its place of central management and control in any of those jurisdictions will be subject to the Code. The Code is administered by the Panel on Takeovers and Mergers (the Panel). Acquisitions can be made by takeover offer (where a bidder makes an offer to the target’s shareholders to buy their shares that they accept or decline on an individual basis) or by way of a scheme of arrangement (where the approval of the relevant percentage of the target’s shareholders is obtained at a court-convened meeting, and then separately sanctioned by the court).

ii Due diligence and access to information

For acquisitions that are subject to the Code, due diligence and access to information is much more limited (particularly if the offer is hostile or if there is a competing bid). Targets can also be reluctant to share information owing to the obligation in the Code to make any information provided to one bidder available to any other competing bidders. This means that lenders may well not have access to the same level of due diligence as would typically be carried out by the purchaser and its advisers in a private acquisition, and may have to rely on public information (which may be out of date or not fully comprehensive) to assess the credit risk of the enlarged group.

If details of a possible offer leak into the market before the purchaser makes the formal offer, an automatic 28 day ‘put up or shut up’ deadline may be triggered, which limits how much due diligence can be carried out before the financing is finalised to enable the bid to be made.

If potential lenders hold or may hold shares in the target, there can also be issues because of the Code requirements on equality of information to target shareholders, publishing material information provided to shareholders and special deals with shareholders. There is also risk that the lenders could be determined to be acting in concert with the bidder to obtain control of the company, which would mean their shareholdings would count when
determining if the 30 per cent threshold for a mandatory takeover offer has been reached (but note that where shares have been charged as security for a loan and, as a result of enforcement, a lender breaches the threshold, the Panel will not normally require an offer if disposals are made within a limited period to take the lender and persons acting in concert with it below the 30 per cent threshold). As a result, if a potential lender may also hold shares in the target, it must either establish effective information barriers between those making debt-financing decisions and those making equity investment decisions or give an undertaking that no member of its group will acquire shares in the target, save for certain limited circumstances.

iii Certain funds and conditionality

The Code contains certain funds provisions which only allow an offeror to announce a bid after ensuring any cash consideration can be fulfilled. These provisions also require the bidder’s financial adviser to confirm that the bidder has sufficient cash resources to do so. Offers cannot normally be made subject to any financing condition.

In practice, this requires the loan documentation to be fully negotiated and signed before the offer is made, with the conditions to drawdown either satisfied or in agreed form and within the bidder’s control, with limited circumstances in which a lender can refuse to lend (with the usual drawstops, such as events of default or breaches of representations or undertakings not applying). This requires lenders to be fully committed early in the offer process and remain committed for the duration, which can have cost implications for borrowers. It is also very difficult for bidders to rely on conditions such as material adverse change to exit the offer process once it starts, as this can only be done with Panel consent, which the Panel only gives in exceptional circumstances (e.g., the Panel did not permit bidders to rely on their MAC conditions as a result of the stock exchange crash following the attack on the World Trade Centre on 9/11), so conditionality in the financing documents will also be restricted in that regard. The two exceptions to this are the minimum acceptance condition and UK or European antitrust clearance.

iv Disclosure

The offer document or scheme document produced in connection with an acquisition that is subject to the Code will need to contain specified details on how the offer is to be financed and the sources of finance, including any fees and expenses to be incurred. Documents relating to the financing have to be made available on a website from the announcement of a firm intention to make an offer until the end of the offer, though the Panel may be willing to allow redaction of, or delayed disclosure of, commercially sensitive provisions such as headroom for potential increases to offers and market flex arrangements.

v Syndication

The Code may also impact the creation of the financing group and the ability to syndicate. Before an offer is announced, lenders can only be approached if it is necessary to do so and after consultation with the Panel, and there are tight limits on how many lenders can be approached by a bidder (before the bidder has been publicly named, the number of external parties approached (which includes shareholders, equity providers and lenders) is restricted to six). Even once announced, the requirement for certain funds (as described above) together with the limited available information and access to target management may mean syndication only once the offer has been declared unconditional or the scheme has been sanctioned by the court.
vi Squeeze out
A successful offer does not necessarily mean that a bidder will acquire 100 per cent of the target from the start. If the offer is not by way of scheme, the required level of acceptance can be as low as 50 per cent of the voting shares. Lenders will usually seek a minimum 90 per cent acceptance threshold, which will enable a squeeze-out process under the CA 2006 to be undertaken to remove minorities. However, this threshold may not be obtainable in practice, so lenders typically will accept a 75 per cent threshold instead as this will, unless successfully challenged by minority shareholders, typically permit reregistration of the target as a private limited company and will enable ordinary and special resolutions to be passed – in particular to delist and avoid the onerous financial assistance rules below.

vii Financial assistance
Until such time as the target is reregistered, it will not be able to be part of any security package for any financing that relates to making the offer owing to financial assistance restrictions in the CA 2006 that prevent an English public company whose shares are being acquired from giving financial assistance for the purpose of that acquisition unless certain exceptions apply. Financial assistance is broadly defined and includes the granting of security or the provision of guarantees and assistance to reduce or discharge a liability incurred for the purposes of the acquisition.

VII THE YEAR IN REVIEW
Activity levels this year have remained strong. There has been lots of investor demand fuelled in part by high levels of CLO issuance (which has been much higher than last year), meaning that sponsors and borrowers or issuers continue to be able to raise funds on favourable terms.

Credit funds continue to win market share, albeit on the smaller transactions, in terms of volume of deals being financed with privately placed unitranche and other private debt deals.

Covenant packages continue to move in favour of sponsors or borrowers. In particular, loan terms continue to converge with high-yield bond terms. Loan volumes have, perhaps as a result of this and the lack of call protection, this year outstripped high yield issuance.

VIII OUTLOOK
At the time of writing, Brexit and Brexit negotiations dominate the headlines. March 2019 rapidly approaches, at which point the UK government has committed to withdraw from the European Union. What the agreement will be, whether there will be an agreement and any transition arrangements remain undecided at this point. If Brexit does go ahead then there may well be changes to the laws that apply through direct EU Regulations, albeit one would expect it unlikely that the government will seek to repeal all such Regulations immediately.

The next six months will be an interesting time in the UK, and there may yet be another referendum that could reverse the decision to leave the EU.
I OVERVIEW

The leveraged acquisition lending market in the United States continues to be robust, with financing available from a multitude of different types of financing sources providing a mix of debt products, including covenant-lite term loan facilities that are broadly syndicated, high-yield bonds, middle market ‘club deal’ term loans and both cash flow and asset-backed revolving facilities for ongoing working capital needs. Acquisitions are financed using these debt products depending on the size of the deal, credit profile and other deal-specific considerations. Financing sources include commercial banks, investment banks and institutional investors including collateralised loan obligations, hedge funds, loan participation funds, pension funds, mutual funds, business development companies and insurance companies. Over US$2.5 trillion of loans were issued to corporate borrowers in the United States in 2017, and a record-setting US$1.4 trillion of those were leveraged loans. This represented a 60 per cent increase in leveraged lending from 2016.²

II REGULATORY AND TAX MATTERS

i Regulatory issues

Regulatory issues arise in a number of contexts in connection with leveraged and acquisition financings. Non-US banks or non-bank lenders may, depending on the breadth and geographical location of their activities, be subject to federal or state licensing requirements. Additionally, US financial institutions and non-US financial institutions that maintain a formal US banking presence are subject to anti-money laundering laws and regulations, and all US persons must comply with sanctions regulations issued by the Treasury Department’s Office of Foreign Assets Control. Certain prudential limitations may also apply: lenders that extend credit to a borrower that uses the proceeds to purchase publicly listed equity securities may be subject to US margin regulations, and US financial institutions that engage in leveraged lending are subject to supervisory guidance issued by the federal banking regulators.

¹ Lauren Hanrahan, Eschi Rahimi-Laridjani and Douglas Landy are partners and Morgan Lingar, James Kong and Archan Hazra are associates at Milbank LLP. The information in this chapter was accurate as at November 2018.

regarding safe and sound lending practices. Other issues may arise where a loan is secured by government receivables, or where a bank attempts to condition the availability of a loan on the customer also obtaining another product or service from the bank or its affiliate.

**Licensing**

The question of whether commercial lending activity triggers any licensing issues is often a fact-specific analysis that may depend on the location of the lender, the location of the borrower and potentially, the location of the collateral. As a general matter, acting as a lender of record under a commercial, syndicated loan would not in itself cause non-US lenders that do not maintain a formal US banking presence to be subject to any specific licensing requirements under federal law. However, if a foreign bank regularly engages in the 'business of banking' in the United States, or if it would like to develop and maintain ongoing relationships with US borrowers, the Federal Reserve may require the bank to maintain a formal US presence in the form of a chartered bank or a licensed US branch or agency office. Additionally, a number of states have licensing regimes applicable to non-bank lenders acting in that state, although many of these states exempt non-bank lenders that make large commercial loans from those licensing requirements. Engaging in loan collection activities or enforcing on collateral may also trigger authorisation requirements in a number of states, although in the context of a syndicated loan, these requirements would generally only apply to the extent the lender is acting in the capacity of the administrative or collateral agent.

**Anti-money laundering and sanctions**

All US persons, including US financial institutions and the US operations of foreign banking organisations, are required to comply with sanctions regulations issued by the Treasury Department’s Office of Foreign Asset Control. These regulations generally require financial institutions to block the accounts and other property of certain ‘targeted’ countries, entities and individuals and to reject any dealings or transactions with these targeted groups or individuals. Additionally, all US financial institutions (including the US banking operations of foreign banking organisations) are subject to US anti-money laundering, know-your-customer, reporting, and other similar requirements.

In May 2018, regulations issued by the Treasury Department’s Financial Crimes Enforcement Network regarding beneficial ownership information came into effect. These regulations require all subject financial institutions to obtain, with certain exceptions, a certification from each legal entity customer that identifies the beneficial ownership information of that customer. A financial institution must obtain this information from the customer each time an ‘account’ is opened with that institution. An ‘account’ is defined broadly as the establishment of any formal banking relationship between the institution and the customer, and includes an extension of credit (or even a renewal of an existing credit).

**Margin regulations**

The US margin regulations impose restrictions on the amount of credit that may be extended by a US lender to any person for the purpose of buying or carrying ‘margin stock’ (a ‘purpose credit’), if the credit is secured ‘directly or indirectly’ by margin stock. Margin stock generally includes, with certain exceptions, any equity security traded on a national securities exchange. ‘Direct’ security encompasses legally recognised security interests such as liens and pledges, while ‘indirect’ security includes, among other scenarios, arrangements where the borrower’s...
right or ability to sell, pledge or otherwise dispose of margin stock owned by the borrower is in any way restricted while the credit remains outstanding. Negative pledges or covenants prohibiting the sale or transfer of assets give rise to an indirect security, as does an agreement by the borrower to directly pledge margin stock as collateral at a later date.

The margin regulations are subject to a number of fact-specific exemptions and safe harbours, including exemptions for credit extended ‘outside the United States’. In the absence of an available exemption, the loan amount may not exceed the ‘maximum loan value’ of the collateral securing the credit. The maximum loan value of margin stock is 50 per cent of the market value of the margin stock, while all other collateral has a maximum loan value equal to its ‘good faith loan value’ (not to exceed 100 percent of the current market value of the collateral).

**Leveraged lending guidance**

In March 2013, the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation issued a joint ‘Interagency Guidance on Leveraged Lending’. US banking organisations are subject to the guidance on an enterprise-wide basis, while foreign institutions are subject to the guidance with respect to leveraged loans that are originated and distributed in the United States. The guidance discusses the agencies’ expectations with respect to the leveraged lending process, including with respect to underwriting standards, valuation standards and pipeline management.

In June of 2017, the Treasury Department released a report reviewing the current US financial regulatory landscape and presenting potential changes and recommendations for reform, including with respect to the leveraged lending guidance. The report acknowledged concerns regarding the guidance presented by market participants, and in particular, highlighted the level of ambiguity left in the definition of leveraged lending. In late 2017, the US Government Accountability Office deemed the guidance to be a ‘rule’ that should have been submitted for Congressional review under the Congressional Review Act, and the then-heads of the US bank regulatory agencies responded by submitting letters to Congress indicating that the agencies would consider revising and reproposing the guidance for public comment. As of this writing, however, the guidance has not been reproposed. In September 2018, the three federal bank regulatory agencies and the National Credit Union Administration issued a joint statement clarifying that supervisory guidance does not have the force and effect of law, but rather outlines the agencies’ supervisory expectations and priorities. Nevertheless, non-compliance with the terms of a guidance may lead a regulator to determine that a subject financial institution is engaged in unsafe or unsound practices.

**Federal Claims Act**

Issues under the Federal Assignment of Claims Act may arise where a loan is collateralised by receivables from the US government. As a result, banks should ensure that any assignments of such receivables are compliant with the requirements and procedures specified in the statute. Similar issues may arise in a number of states or municipalities that maintain analogous laws.

**Anti-tying rules**

US bank anti-tying rules generally prohibit any US bank, as well as the US branches and agencies of foreign banking organisations, from conditioning the availability of (or varying the prices of) credit (the ‘tying’ product) on a customer also obtaining an additional product
or service from the bank or its affiliate (the ‘tied’ product). For example, a bank may not tell a client that it will not participate in a bridge loan to the client unless such client also engages the bank as underwriter for a related bond offering. Certain fact-specific exceptions and safe harbours to the general prohibitions are available, including those available where the tied product is a ‘traditional bank product’ (such as another loan), or where the borrower is a foreign entity organised and having its principal place of business outside the United States.

ii Tax issues

Withholding taxes

The United States generally imposes a 30 per cent federal withholding tax on US-source interest paid to a non-US lender. For these purposes interest is generally US-source if it is paid on a debt obligation of a US person (such as a US corporation) or of certain non-US persons engaged in a US trade or business. A 30 per cent federal withholding tax may also be imposed on other payments made under loan agreements, such as letter of credit and other fees.

Interest is exempt from this withholding tax if a non-US lender qualifies for the ‘portfolio interest exemption’. In order to qualify, a non-US lender must not (1) be a bank receiving interest on an extension of credit entered into in the ordinary course of its trade or business, (2) be a controlled foreign corporation (as defined for US federal income tax purposes) related to the borrower or (3) own 10 per cent or more of the total combined voting power of all voting stock of the borrower (or, if the borrower is a partnership, 10 per cent or more of the capital or profits interests in the borrower). The non-US lender must also submit a properly completed IRS Form W-8BEN-E or W-8BEN (if it is an individual). Moreover, the debt obligation itself must be in ‘registered form’ for US federal income tax purposes and interest on the debt obligation cannot be determined by reference to receipts, sales, cash flow, income or profits of, the change in value of property owned by, or dividends, partnership distributions or similar payments by, the borrower or a related person (i.e., ‘contingent interest’).

The US federal withholding tax on interest can also be eliminated or reduced under an income tax treaty between the United States and the non-US lender’s home jurisdiction, provided the non-US lender is eligible for the benefits of the treaty. Treaties may also exempt fee income from US federal withholding tax. In order to claim treaty benefits, a non-US lender generally must submit a properly completed IRS Form W-8BEN-E or W-8BEN.

If a non-US lender is engaged in a US trade or business (such as the US branch of a non-US bank), US-source interest and fees that are effectively connected with that trade or business are not subject to US federal withholding tax. Instead, such amounts are subject to US federal net income tax and, for foreign corporations, the branch profits tax. To avoid gross basis withholding such a non-US lender is required to provide IRS Form W-8ECI to the borrower.

FATCA

Under the provisions commonly referred to as ‘Foreign Account Tax Compliance Act’ or FATCA, a 30 per cent withholding tax may be imposed on payments of US-source interest on and fees with respect to and, on or after 1 January 2019, gross proceeds from the sale, redemption, retirement or other disposition (which would include the repayment of principal) of, a debt obligation that produces US-source interest. The withholding tax applies to payments to ‘foreign financial institutions’ that do not (1) enter into an agreement
with the US Internal Revenue Service under which they undertake certain due diligence, reporting and other obligations or (2) comply with legislation in their home jurisdictions implementing the intergovernmental agreement between the United States and their home jurisdiction relating to FATCA pursuant to which they need to undertake similar obligations. FATCA withholding also applies to payments to certain non-financial foreign entities unless such an entity either certifies that it has no ‘substantial United States owners’ or provides certain identifying information about each owner. Debt obligations issued before (and not significantly modified on or after) 1 July 2014 are exempt from FATCA withholding under a grandfathering rule.

**Deductions**

Interest and original issue discount on an instrument treated as debt for US federal income tax purposes is generally deductible as it accrues, subject to various limitations. Affiliated corporations filing a consolidated US federal income tax return generally are permitted to deduct interest against the group’s income.

Legislation passed at the end of 2017 limits net business interest expense deductions for most businesses, regardless of form, to 30 per cent of their ‘adjusted taxable income’. Net business interest expense is the excess of ‘business interest expense’ over ‘business interest income’. The disallowance does not apply to ‘investment interest,’ but the US Internal Revenue Service has provided guidance that a C corporation will not be treated as having ‘investment interest’ for this purpose. Thus, all interest income and interest expense of a C corporation will generally be accounted for in computing the limitation. For tax years beginning 2018 to 2021, adjusted taxable income should approximate a business’ EBITDA. For tax years beginning after 2021, it should approximate EBIT.

Original issue discount on ‘applicable high yield debt obligations’ or ‘AHYDOs’ may not be deducted until paid and, depending upon the yield of the instrument, a portion of the deduction may be permanently disallowed. A debt obligation is an AHYDO if, for US federal income tax purposes, it is issued with ‘significant original issue discount’, has a maturity in excess of five years and has a yield in excess of certain statutory thresholds. In practice, the limitation on deductions can be avoided if the debt instrument provides for adequate prepayments, known as ‘AHYDO catch up payments’.

Deductions for interest and original issue discount are also limited or deferred if a non-US lender is related to the borrower or if the debt is required to be paid in (or principal or interest is required to be converted to or determined by reference to the value of) equity of the borrower or a related party.

**Credit support**

If a controlled foreign corporation guarantees, or directly or indirectly pledges its assets in support of, the obligations of a related US borrower, this credit support could result in a deemed dividend to its direct or indirect ‘United States shareholders’. As a result, a controlled foreign corporation generally is not required to guarantee the debt obligations of an affiliated US borrower, and no assets of a controlled foreign corporation may be pledged to support the debt of an affiliated US borrower. In addition, no more than two-thirds of the voting equity of a first tier controlled foreign corporation may be pledged in support of such debt.

A controlled foreign corporation is a non-US corporation more than 50 per cent of the vote or value of which is owned, directly, indirectly or by attribution, by United States shareholders. A United States shareholder is a United States person that owns 10 per cent or
more of the vote or value of a non-US corporation. Legislation enacted at the end of 2017 broadens the application of the constructive ownership and attribution rules, resulting in more foreign corporations being treated as controlled foreign corporations. Under current rules, foreign subsidiaries of a foreign parent company may be controlled foreign corporations if the foreign parent also owns a US subsidiary. While non-US subsidiaries of non-US parent companies may now be controlled foreign corporations, deemed dividends only result in adverse US tax consequences if equity in such a controlled foreign corporation is owned directly, or indirectly through other non-US entities, by a United States shareholder.

Moreover, deemed dividends only arise if a controlled foreign corporation has earnings that have not been previously taxed in the United States. Owing to the deemed repatriation of offshore earnings pursuant to tax legislation enacted at the end of 2017, the amounts of such untaxed earnings have been greatly reduced. However, many controlled foreign corporations will continue to have earnings that would be taxed less favourably if included as a deemed dividend by a United States shareholder. As a result, loan documents continue to limit, or exclude, guarantees and pledges by or with respect to controlled foreign corporations. However, it should be possible to limit the scope of controlled foreign corporations subject to these limitations to those with direct or indirect United States shareholders.

### III SECURITY AND GUARANTEES

#### i Guarantees

In acquisition financings involving a US borrower, all of the borrower’s material US subsidiaries (subject to customary exclusions) usually provide a guarantee of the borrower’s obligations (an upstream guarantee) for the benefit of the lenders and other secured parties. In addition, a downstream guarantee of the borrower’s obligations is provided by the parent holding company.

#### ii Security interest

In acquisition financings involving a US borrower, all or substantially of the borrower’s and guarantors’ assets are pledged for the benefit of the lenders and other secured parties (subject to customary exclusions). Other than interests in real property, most security interests are governed by a single security agreement. Some of the assets commonly included in a security agreement are goods, equipment, investment property, securities, securities accounts, deposit accounts and letter of credit rights. The security interest in such collateral typically extends to proceeds and after-acquired assets.

#### iii Creation and perfection

The Uniform Commercial Code (UCC), which varies slightly by state, governs security interests. A security interest is only good as long as it is attached and perfected. Attachment of the security interest gives the lenders legal rights against the borrower’s assets in the event of default. Attachment requires that value is given to the borrower, the borrower has rights in the collateral and there is a security agreement describing the collateral and executed by the borrower. Meanwhile, perfection gives the lenders’ security interest in the assets priority over the interests of other secured parties in a potential bankruptcy process. Depending on the type of asset, perfection under the UCC can be achieved by filing a financing statement, by possessing the collateral, by controlling the collateral or automatically upon attachment. The perfection of security interests in most types of assets is generally accomplished by the filing
of a UCC financing statement in the applicable filing office, which for borrowers that are US corporations, limited liability companies or registered partnerships is the state of organisation of the borrower. Certain other asset classes of UCC collateral (described below) are subject to different rules. Real property is subject to mortgages governed by and filed in the law of the state in which the real property is located.

iv Deposit accounts
A lender can only perfect its security interest in a deposit account through control. The lender and the depository bank will typically enter into a control agreement, under which (often upon receipt of notice) the depository bank will manage the funds in the deposit account according to instructions from the lender, without any further consent from the borrower. Deposit accounts can also be automatically perfected if the depository bank and the lender are the same entity.

v Investment property, securities accounts
The most common types of investment property are certificated or uncertificated securities and security accounts. A security account is maintained by a securities intermediary, which can be a clearing corporation or a financial institution. Perfection by control is preferred and can be achieved by the lender and the securities intermediary executing a control agreement. Alternatively, the lender can file a UCC financing statement to perfect its security interest. In the case of certificated securities, perfection by possession is preferred to filing a financing statement, in which case the lender (or its agent) will physically obtain the share certificates. Uncertificated securities may be perfected by control by entering into an agreement between the lender and the issuer of the security or by the filing a UCC financing statement.

vi Intellectual property
The security interests in intellectual property are subject to both the UCC and federal regulations. Filing of a UCC financing statement is generally sufficient to perfect security interests in patents, trademarks, and unregistered copyrights. The Copyright Act, on the other hand, expressly requires recordation with the United States Copyright Office to perfect a security interest in copyright registration or application. US federal courts split on the issue of whether an unregistered copyright can be perfected under the UCC. Consequently, in practice, filings are often made with the United States Patent and Trademark Office (USPTO) or the United States Copyright Office and by UCC financing statement.

IV PRIORITY OF CLAIMS
When the debtor files for bankruptcy under Chapter 7 or Chapter 11, assuming that its security interests are properly perfected and not avoided, the secured lenders will get paid the value of their collateral (up to the amount of their secured obligations) prior to the payment of unsecured claims. If the security interest is not properly perfected or is avoided, it can be effectively subordinated to other claims against the obligors. Moreover, a claim can be subordinated or invalidated in various ways such as through an intercreditor agreement, equitable subordination (described below), fraudulent conveyance (described below), or preference, although notably there are no financial assistance rules in the US.

In the US, intercreditor agreements are generally respected in bankruptcy. US intercreditor agreements generally rely on waivers by junior secured lenders of various secured
creditor rights under the Bankruptcy Code, which are generally respected by the bankruptcy courts, instead of the payment subordination and enforcement standstill provisions that are often seen in intercreditors of some other jurisdictions.

The Bankruptcy Code grants courts discretion to order a claim of a lender with equity or another preferable position to be subordinated if that lender engaged in severe inequitable conduct to the detriment of other lenders.

Furthermore, the Bankruptcy Code (and similar state laws) allows the creditor to claw-back certain transfers made within certain time periods before the debtor files for bankruptcy, where a ‘transfer’ is defined broadly to include non-monetary acts such as the perfection of a security interest. In the case of either actual or constructive fraudulent transfers, a security interest can be invalidated and thus subordinated to other unsecured claims. In the context of acquisition financing, courts look at two factors to determine constructive fraudulent transfers. First, they determine whether there was less than reasonably equivalent consideration, and second, they look to whether the target transferor was insolvent or had inadequate capital at the time of transfer. While upstream and cross-stream guarantees are commonly used and generally permissible, they may be subject to claims of fraudulent transfer.

V JURISDICTION

In credit agreements and debt commitment letters, borrowers and lenders must choose a specific US state to be the governing law. A choice of law provision and a submission to jurisdiction clause determine the substantive law that governs the agreement and the jurisdiction in which to litigate disputes, respectively. Most often, lenders prefer New York governing law and submission to the state and federal courts sitting in New York City, New York. In addition, foreign judgments and awards will generally be respected.

VI ACQUISITIONS OF PUBLIC COMPANIES

i Certain funds

There are no statutorily required conditions precedent to funding a US acquisition financing. The US market has for some time incorporated the ‘Sungard’ approach, which provides comfort to the purchaser and seller under an acquisition agreement that any ‘daylight’ between the conditions to the acquisition and the conditions to the acquisition financing have been mitigated. However, depending on deal dynamics (such as the seller’s expectations and the jurisdiction of the target) financing sources may accept ‘certain funds’ conditionality similar to the construct that is required (in some cases) and customary in the UK M&A market.

ii Margin regulations

Issues under the US margin regulations may arise where a borrower uses the proceeds of a financing for the purpose of acquiring a US public company. Shares of these companies are considered ‘margin stock’ and to the extent such a financing is secured directly or indirectly by margin stock (as discussed above), the loan would be subject to the margin regulations’ limitations regarding the maximum amount of credit that may be extended.
iii Confidentiality

In connection with the shareholder vote to approve the acquisition of a public company, public shareholders of the target will need to be provided with public disclosure that will include a generic sources and uses (but not a description of the flex terms in any debt commitment letters). There are no statutorily required confidentiality requirements or other restrictions on debt issuance or syndication while a public company is pending completion of an acquisition (although the usual concerns about material non-public information will be present).

VII THE YEAR IN REVIEW

The past year has continued to see favourable conditions, increasing interest rates and an increasingly favourable regulatory environment (as discussed above), which has given borrowers significant negotiating power in recent transactions. Recent large acquisition financings, such as Refinitiv, the speciality chemicals business of AkzoNobel and Envision Healthcare, illustrated the strength of the bank and bond markets to complete large acquisition financings. The overall leveraged lending default rate has been inside the historical average of 3.1 per cent, and this is unlikely to change materially through the end of 2018. In addition, the finance community over the last year has been interested in the need to find a replacement for LIBOR-based interest rates and determining which construct will be the most likely replacement.

VIII OUTLOOK

The leveraged acquisition lending market looks like it will continue to be strong in the coming months. Rising interest rates have intensified investor appetite for floating rate loans, in particular. The economic outlook for the United States remains generally encouraging. Although always difficult to predict, no new legislative initiatives that would impact the finance markets are expected. Consequently, the fundamentals for leveraged finance remain positive and liquidity remains strong.
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Tomás Allende has been a partner of the firm since 2016, when he rejoined as partner following eight years serving as chief regional legal counsel for Latin America for the Rohatyn Group. He started his career at BV in 1995, where he was first appointed partner in 2006.

His practice areas include private equity funds, M&A, lending, and investments in conventional and renewable energy. He has participated in complex multijurisdictional fund structuring and also been involved in several M&A and financial transactions throughout the region. He also has broad experience in corporate governance of family companies.

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Tomás has been top-ranked in ‘best lawyers under 40’ by Apertura magazine (an Argentine business publication) from 2007 to 2014, and also honoured as the best individual M&A lawyer for Latin America in 2011 by International Law Office (ILO) in association with the Association of Corporate Counsel (ACC).

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Jean Anderson is a partner and a member of the Banking and Finance Law Group of Goodmans. Her practice focuses on financing, corporate transactions and regulatory matters. With more than 35 years of legal experience, she has developed extensive expertise in the areas of project finance, structured finance, asset-based lending, P3 finance, debt restructuring and complex domestic and cross-border financings and regulatory matters relating to foreign and domestic financial institutions. Clients represented include Wells Fargo, Bank of America, Monroe Capital, Hitachi Capital, OMERS, Citizens Bank, US Bank, UBS, AB Private Credit, Carlyle Global Credit and Clearwater Seafoods.

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Jie Chai is a partner of Tian Yuan. He received his LLM degree from Tulane University, US (honoured with a scholarship at Tulane Law School) and LLB degree from Peking University, PRC. He is fluent in both English and Mandarin.

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His main areas of practice have included construction, public procurement, foreign direct investment, mergers and acquisition, minerals and natural resources, international trade, outsourcing, and intellectual property, serving industries from energy and infrastructure to minerals and natural resources. In addition to suitable contractual framework and legal arrangements, project finance, and bonding, he also provides legal advice on claims and dispute resolutions.
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Borja Contreras joined _Uría Menéndez_ in 2011, and he has been a senior associate of the firm since 2018. Between September 2017 and June 2018, Borja worked in the New York office of Paul, Weiss, Rifkind, Wharton & Garrison LLP, where he was a visiting lawyer in the finance team.

Borja has over eight years of experience advising on M&A and corporate, acquisition, real estate and project finance. He has also advised creditors and debtors on restructuring the debt of some of Spain's biggest companies. Since 2011, he has also participated in several transactions involving non-strategic assets of financial institutions, such as non-performing loans, real estate assets and property management platforms.

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Caroline Descours is a partner in the corporate restructuring group at Goodmans, which is consistently and widely recognised as Canada's best and leading corporate restructuring practice.

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Caroline’s representative work includes: company counsel on numerous corporate recapitalisation transactions, including Concordia International Corp, Bellatrix Exploration Ltd, Sherritt International Corporation, Postmedia Network Canada Corp and Millar Western Forest Products Ltd; debtor counsel on numerous commercial insolvency restructurings, including Cinram International Inc, Graceway Canada Company, SkyLink Aviation Inc, Plasco Energy Group, Nelson Education and Rubicon Minerals; debtholder counsel on numerous commercial insolvency restructurings, including Sino-Forest, Jaguar Mining, Mobilicity and Cash Store; monitor, trustee and/or information officer counsel on numerous commercial insolvency restructurings, including Extreme Fitness, Tamerlane Ventures, Target Canada, Horsehead and FirstOnSite.

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Lauren Hanrahan, a partner in the firm's leveraged finance group, has significant experience in representing lenders in acquisition financings, recapitalisations, bridge and mezzanine financings, debtor-in-possession, exit facilities, special situation financings and other complex secured lending transactions. She also devotes a portion of her practice to serving as agent's counsel or lead investor's counsel in connection with amending and restructuring troubled loans and negotiating workouts.

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Mr Hanrahan has extensive experience representing lenders in acquisition financings, including leveraged buyouts, tender offers and other going private transactions. He has handled major transactions for financial institutions such as Bankers Trust Company, Barclays Bank PLC, The Chase Manhattan Bank, Credit Suisse, Goldman Sachs Credit Partners LP, HSBC and The Royal Bank of Scotland.

Year after year, Chambers USA, Chambers Global, Euromoney’s ‘Guide to the World’s Leading Banking Lawyers’, The Legal 500 and other guides to the legal industry consistently rank Mr Hanrahan in the top tier of his practice. Chambers recently noted, “The “superb” Marc Hanrahan is widely regarded as a “phenomenal leveraged finance lawyer,” who sources love to deal with because he has “seen it all, done it all,” and “his work is of the highest quality.”’

‘Clients say he “exhibits first-class knowledge in senior lending transactions and is particularly adept when acting as lenders' counsel. Unsurprisingly he continues to work with some of the industry’s leading global financial service firms.’ The Legal 500 notes, “Outstanding” practice head Marc Hanrahan is a big name in the market.’ Additionally, he was highlighted in the The Legal 500 Hall of Fame this year for, ‘an individual who receives constant praise by their clients for continued excellence and who is at the pinnacle of the legal profession.’

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Mr Kirkland’s experience also extends to general corporate finance, capital markets transactions and asset-backed lending arrangements, including margin loans, as well as restructurings.

In addition to his time at Gilbert + Tobin, he has worked in the London offices of two large international firms.

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James Kong, an associate in the firm's Leveraged Finance Group, has counselled US and foreign financial institutions on a diverse range of regulatory and compliance matters, particularly with respect to the requirements of the Volcker Rule and other aspects of the Dodd–Frank Act. He also has experience in drafting and negotiating futures and options agreements, cleared swap documentation, and other trading documentation on behalf of both buy-side and sell-side market participants.

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Florian Kranebitter is partner at Fellner Wratzfeld & Partners, specialising in banking and finance, corporate and M&A, antitrust and competition law, as well as insolvency law and restructuring. Admitted to the Austrian Bar in 2004, Florian has an LLM from the University of California and a mag iur from the University of Vienna.

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Douglas Landy is a partner of the firm's leveraged finance group, and he is noted for his deep experience in banking and securities laws, as well as his thorough and practical legal analysis. He represents many of the leading global banks and central counterparties in transactional and advisory matters. He is expert in the Volcker Rule, block chain and cryptocurrencies, capital requirements, bank insolvency and foreign banks in the US.
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Morgan Lingar is an associate in the firm’s leveraged finance group. She has experience representing lenders in acquisition financing, including leveraged buyouts, in both domestic and cross-border transactions.

LÁSZLÓ LOVAS
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László Lovas is a member of the banking and finance team. He has been involved in cross-border and domestic acquisition, real estate and project finance deals and has experience in portfolio transfers and establishment of collaterals. Laszlo completed his legal studies at the University of Pécs, Hungary.

QIN MA
Tian Yuan Law Firm
Qin Ma is a senior associate in Tian Yuan Law Firm. She received her LLM degree from Fudan University and LLB degree from Shanghai University. She was fully sponsored to participate in the LLM programme of Tulane Law School, United States, as an exchange student. She is admitted in the United States as a member of the State Bar of New York, and is also admitted in China.

Qin Ma practises mainly in the areas of outbound M&A, project financing, foreign direct investment, EPC contracts and other corporate matters. Qin Ma is the co-author of the China chapter of Getting the Deal Through – Acquisition Finance 2014, and the co-author of the China chapter of Acquisition and Leveraged Finance 2018, both published by Law Business Research.

SUHRUD MEHTA
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Suhrud Mehta serves as co-managing partner of the London office of Milbank LLP, co-head of the leveraged finance and capital markets practice in London and a member of the Financial Restructuring Group.

Suhrud focuses mainly on leveraged finance and restructuring transactions with a focus on multi-tiered capital structures: across the full range of bank and bond and bank mezzanine and holdco PIK transactions. He has advised on some of the most significant cross-border, public to private, leveraged, infrastructure and investment grade financings in the London/European market.

Suhrud has been recognised as a leader in his field by a number of journals, among them: Chambers UK (which designated him among the first tier of banking lawyers in London), Chambers Global, Chambers Europe, Legal 500, Who’s Who Legal, Super Lawyers and Legal Business (where he was named as one of the leading finance lawyers/rainmakers in London).
He has been described by Chambers UK as ‘driven and technically gifted’, ‘extremely clever, industrious, superb technically, commercial in his outlook, responsive and dynamic’ and by clients as ‘one of the best we’ve worked with, with an exceptionally commercial view of transactions’.

He is the author of a number of articles published in International Financial Law Review and regularly speaks at conferences.

**FRANCESCA MOSELY**  
*Milbank LLP*

Francesca Mosely is an associate in the global leveraged finance group. Her experience includes acting for banks, private equity funds, investors and sponsors on a range of finance and corporate transactions, including acquisitions of distressed assets, bank bond deals and refinancings involving investment-grade borrower groups. She has experience working in a range of sectors including telecoms, agriculture, shipping and automotive, as well as emerging markets.

**DAVID NADLER**  
*Goodmans LLP*

David Nadler is a partner and co-heads the Banking and Finance Law Group at Goodmans. He is also a leading member of the firm’s hospitality law group.

David consistently represents Canadian and international financial institutions, non-bank lenders and public and private companies in connection with complex domestic and cross-border lending transactions. David has worked on several financings in the seniors housing sector, both for lenders and operators. He has also been involved in several debt restructurings representing both creditors and debtors.

David represents various clients in the hospitality industry, including hotel owners, brand management companies and franchisors. David has been involved in hospitality transactions in Canada and throughout the world, including in India, China, the Czech Republic, Hong Kong, Japan, Morocco, Israel and Egypt.

David’s experience includes representation of: Organigram Holdings Inc, a leading licensed producer of cannabis, in connection with a credit facility provided by a syndicate of lenders led by Bank of Montreal; a syndicate of lenders in connection with a credit facility provided to CM Solutions Inc, an OMERS affiliate, in connection with its acquisition of D+H Collateral Management Corp; a syndicate of lenders in connection with a C$1 billion credit facility agreement to one of Canada’s largest pension funds; an owner and developer of a group of branded full-service hotels; a syndicate of lenders in connection with a US$1 billion senior revolving credit facility to one of Canada’s largest real estate companies; Nuvo Pharmaceuticals Inc in connection with acquisition financing with respect to its acquisition of certain assets of Aralez Pharmaceuticals Inc; Stephenson’s Rental Services Inc in connection with term and acquisition credit facilities of C$210 million; APLP Holdings Limited Partnership, a subsidiary of Atlantic Power Corporation in its establishment of C$900 million in new senior secured credit facilities; Toronto-Dominion Bank in connection with the provision of a C$625 million acquisition and operating credit facility to Canadian Apartment Properties REIT; Royal Bank of Canada in connection with the provision of a
C$255 million credit facility to Cologix Inc; Canadian Pacific Railway Ltd in connection with its formation of a joint venture with Dream Unlimited Corp to develop its portfolio of surplus real estate.

David is recognised as a leading banking lawyer by *The Canadian Legal Lexpert Directory*, *Euromoney’s Guide to the World’s Leading Banking Lawyers*, *The Legal 500 Canada*, *Best Lawyers in Canada* and *IFLR 1000*. He has also been recognised for banking by Chambers Global. David has been described as someone who is ‘practical and takes real world scenarios into consideration’ (*The Legal 500 Canada* 2019).

David has co-authored a number of articles in the area of banking and finance, including, most recently, the Canada chapter of the fifth edition of Law Business Research Ltd’s *The Acquisition and Leveraged Finance Review* published in January 2019.

David has served as a board and committee member of several non-profit organisations. He was admitted to the Ontario Bar in 1993.

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After practicing banking and finance for almost 25 years in three large firms, Keyvan Nassiry launched Nassiry Law, a lending law and debt finance boutique firm based in Montreal.

Keyvan’s practice focuses primarily on sophisticated domestic and cross-border financings as well as on turnarounds, private equity, second liens, mezzanine, bridge and hospitality M&A and finance. He holds significant experience in asset-based lending, syndicated loans, real estate loans, securitisation, mine and consumer financings, equipment financing and leasing, factoring, intercreditor relations, consumer finance and other aspects of banking and financing law. Keyvan regularly acts for Canadian, American and offshore banks, PE funds and commercial lenders, as well as borrowers, regarding complex secured and unsecured credit facilities.

Keyvan is a frequent panellist and moderator for CLE programs and private clients. He has ranked consistently among the top practitioners in his field by *The Best Lawyers in Canada*, *Chambers and Partners*, *The Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada*, *Lexpert Leading Canadian Lawyers in Global Mining*, *Lexpert Leading Canadian Lawyers in Energy* and *The Canadian Legal Lexpert Directory*. He is past president of the Montreal chapter of the Turnaround Management Association (TMA) and member of the American Bar Association, Business Law Section.

Keyvan was admitted to the *Barreau du Québec* in 1991.

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Markus Nilssen is a partner of the bank and financing group at BAHR, specialising in capital markets and financial regulations. In addition to being a regulatory expert, he also has a broad experience from advising on various types of corporate and financial arrangements and transactions, including securitisation and other structured finance transactions, factoring, public M&A and general corporate finance work.

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János Pásztor is a member of the tax team and heads the local practice in Budapest. János is a qualified and chartered tax adviser specialising in domestic and international tax planning and tax restructuring, and regularly represents clients in tax litigation proceedings relating to all major types of taxes. He also provides comprehensive tax and legal advice to high net worth individuals and has significant experience in advising players in the retail sector on their business structure. János is a frequently a speaker at domestic and international events on cross-border taxation, tax litigation and tax restructuring, and is a lecturer in the field of tax. Prior to joining Wolf Theiss, János worked in a well known, international professional services firm as a tax manager and attorney at law.

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Chris Payne is a senior associate in a business law group at Goodmans. His practice is transaction-based with a particular emphasis on banking and finance law. Chris has experience representing a variety of private and public companies as well as financial institutions on a range of domestic and cross-border commercial lending transactions, including acquisition finance, project finance and asset-based loans.

Chris also assists companies with corporate restructurings and regulatory matters and maintains a general corporate law practice.

Chris’ representative work includes acting for: Searchlight Capital Partners, LP in connection with its C$2 billion acquisition financing of Mitel Networks Corporation, a global market leader in business communications; Coca-Cola Canada Bottling Limited, a Canadian-based joint venture between prominent businessman and philanthropist Larry Tanenbaum OC, and Junior Bridgeman, a former National Basketball Association player, renowned entrepreneur and owner of Kansas City-based Heartland Coca-Cola Bottling Company, in financing its acquisition of Coca-Cola Refreshments Canada Company from...
Coca-Cola Refreshments USA, Inc, a subsidiary of The Coca-Cola Company; Morneau Shepell Inc in connection with its acquisition of LifeWorks Corporation Ltd for a total purchase price of approximately C$426 million; Wells Fargo in connection with a financing deal to provide American Tire Distributors (ATD) with C$1.05 billion in exit financing to support operations and future growth initiatives at ATD and ensure they emerge from bankruptcy; Brookfield Principal Credit in connection with the US$650 million term loan provided to Bumble Bee Seafoods; SkyPower Corp in connection with its completion of five concurrent refinancings totalling US$230 million by Nomura Securities International for its seven Ontario RESOP solar park projects; CEDA/OMERS in connection with its C$125 million credit facilities with Bank of Nova Scotia; Carlyle Group in its C$225 million credit facility to Empire Communities; CE Mining in connection with a financing of Rambler Metals & Mining; and Hudson Resources in connection with a multi-lender project financing in Greenland.

He was admitted to the Ontario Bar in 2014.

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Melinda Pelikán is a member of the banking and finance team and heads the local practice in Budapest. Melinda has over 12 years of experience assisting clients in financing construction and infrastructure projects, advising on real estate, acquisition finance and restructuring transactions, as well as on cross-border financing and factoring. She also advises insurance companies in connection with their services and products, as well as private equity companies and funds on their transactions in the region. Prior to joining Wolf Theiss, Melinda gained direct experience in the field of banking and finance as senior legal counsel at the Hungarian subsidiary of a large international bank and worked in the Budapest office of other international law firms.

FERNANDO R DE ALMEIDA PRADO
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Fernando R de Almeida Prado is a partner in the corporate area of Pinheiro Neto Advogados in Brazil, focusing on providing legal advice to local and foreign institutions and corporates in a number of areas including M&A, acquisition finance and LBOs, structured finance, aircraft finance, restructuring, derivatives and general financial regulatory matters. Mr Prado holds an LLB from the Mackenzie University Law School in São Paulo. He joined Pinheiro Neto in 1986 and became partner in 1998. In 1996, he worked as a secondee at Linklaters in London, covering international finance and corporate areas.

ESCHI RAHIMI-LARIDJANI
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Eschi Rahimi-Laridjani is a partner in the firm’s tax group and focuses on the taxation of complex financing transactions, financial products and derivatives, US and foreign securities offerings, structured finance and asset securitisation transactions. She has significant
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CASPAR ROSE  
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Caspar Rose is an associate at Magnusson Denmark. He specialises in company law, corporate governance and financial regulation as well as M&A. He also has a background as financial economist working in Danske Bank and Dansk Industri.

PAULA RÖTTORP  
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Paula Röttorp is a partner in the finance group at Hannes Snellman in Stockholm. She advises extensively on acquisition and leveraged finance, but also on project financing of infrastructure, real estate financing and restructuring of existing loans and assets within and outside insolvency situations. She has broad experience of managing large projects and negotiating agreements for private equity investors, and has extensive experience gained from representing lenders and borrowers alike.

JOHN SCHEMBRI  
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John Schembri is the head of Gilbert + Tobin’s banking and infrastructure group. His major area of practice is leveraged and acquisition finance, together with structured and project financing. He also has significant experience in various other areas, including the financing of construction and resources projects, property, acquisition and general corporate financing.

Mr Schembri’s experience also extends to corporate debt and leveraged finance transactions, including the financing of specific asset acquisitions as well as funding general working capital requirements. In this area, he has acted for both lenders and borrowers and in secured, unsecured, syndicated and club loan arrangements.

He is recognised as a leading banking and project finance lawyer in numerous publications including leading directories such as *Chambers*, *The Legal 500*, *Best Lawyers* and *IFLR1000*.

Mr Schembri holds a bachelor of arts degree, a bachelor of laws degree with first-class honours and a master of taxation degree from the University of Sydney. He is admitted as a solicitor of the Supreme Court of New South Wales and the High Court of Australia, and has also been admitted to the Roll of Solicitors in England and Wales and as a solicitor of the Supreme Court of England and Wales.
CARRIE B E SMIT

Goodmans LLP

Carrie Smit is a partner and heads the tax group at Goodmans. Her practice is transaction-based and encompasses all aspects of income taxation that arise in corporate and commercial transactions, including cross-border mergers, corporate reorganisations, domestic and international debt financings, debt restructurings and private equity investments.

Carrie’s representative work includes acting for: Onex Corporation in its agreement to acquire all outstanding shares of WestJet Airlines Ltd for C$5 billion; Searchlight Capital Partners, LP in its acquisition of Mitel Networks Corporation, a publicly listed global market leader in business communications, in an all-cash transaction of US$2 billion; Ceridian HCM Holding Inc, a global human capital management software company, in its US$631.3 million initial public offering of dual-listed common shares in Canada and the United States; Toys ‘R’ Us Canada in its acquisition by Fairfax Financial Holdings Limited and its emergence from creditor protection; and Spectra Energy Corp in its merger with Enbridge Inc for C$37 billion in stock (enterprise value of C$165 billion)


Law Business Research’s Who’s Who Legal: Canada 2018 recognised Carrie as one of the seven ‘Most Highly Regarded Individuals’ in Canada in the practice of corporate tax. Carrie was named the Toronto Tax ‘Lawyer of the Year’ by Best Lawyers in Canada in 2016 and 2018 and she also received the Best in Tax Award at the 2012 Euromoney Americas’ Women in Business Law Awards.

Carrie has spoken at numerous tax conferences and has written papers on a variety of income tax matters. She is a regular speaker at the annual CBA ‘Tax Law for Lawyers’ conference. She was admitted to the Ontario Bar in 1992.

MARK STAMP

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As co-head of the London corporate team, Mark’s practice covers a broad range of international and domestic corporate, M&A and securities work. Mark advises on complex, cross-border public and private mergers and acquisitions, joint ventures, private equity, equity capital markets, restructurings, corporate governance and general corporate law matters.

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Søren Theilgaard is a Danish attorney (advokat) and senior counsel at Magnusson Denmark. He has been practising law in the international environment for 45 years. From 1993 he was company secretary/general counsel at Codan Insurance. During 2010–2015, he was head of the Nordic legal department at AIG Insurance. He has focused on international contract
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Magnus Tønseth is a partner of the bank and financing group at BAHR and advises bank lenders and arrangers, investment banks and borrowers on bank and bond financings and financial restructurings. He has particularly extensive experience within the energy, shipping and offshore sectors, often involving complex legal structures and high value assets across multiple jurisdictions, and has also worked widely with private equity acquisition financing.

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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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Odilo Wallner is a member of the firm’s banking and leveraged finance group. He has broad experience in the field of banking law, credit financing and debt capital markets transactions with a focus on acquisition and general leveraged financing, asset-based financing and high-yield bonds. Odilo has developed significant expertise in the interaction and combined implementation of loan financing and debt capital market issuances. He also specialises in factoring and asset-based lending arrangements in Germany and in international transactions. He regularly advises, borrowers/issuers, sponsors and financial institutions.

Odilo Wallner studied law at the Martin Luther University Halle-Wittenberg (LLM) and Durham (England) (LLM). Before joining Milbank, he worked for several years at an international law firm in Munich and Frankfurt.

Odilo Wallner is admitted in Germany (as a Rechtsanwalt) and speaks German and English.
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Maurus Winzap is a partner in the tax team of Walder Wyss. He focuses on domestic and international tax issues, particularly in corporate reorganisations, restructurings, structured finance, acquisitions and divestments. Other areas of expertise include tax planning for collective capital investments and cross-border relocations. He lectures and publishes regularly in the field of taxation. Mr Winzap is a lecturer in international tax at the Swiss Institute of Taxation. He was the chair of the organising committee of the 69th congress of the International Fiscal Association (IFA), which took place in Switzerland in 2015. In addition, he is a member of the executive board of the Swiss Tax Law Association (Swiss branch of the IFA).

Mr Winzap was awarded his degree in law from the University of Zurich in 1997 and his Master of Law degree from the University of Virginia in 2002. He was admitted as a Swiss-certified tax expert in 2004.

Mr Winzap speaks German and English. He is registered with the Zurich Bar Registry and admitted to practise in Switzerland.

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David Wiseman is a partner in a business law group and a long-standing member of the Opinions Committee and the Technology Committee at Goodmans.

David is recognised as a leading lawyer in the areas of bank lending, project finance, asset-based lending and global mining by IFLR 1000, Best Lawyers in Canada, Who's Who Legal and Lexpert. David also has the highest possible rating (AV Preeminent) from LexisNexis Martindale-Hubbell for ethical standards and legal ability.

David has written and spoken on debt finance topics in a variety of forums, including co-authoring and editing the Canada chapter of The Acquisition and Leveraged Finance Review and The Lending and Secured Financing Review. David previously was a member of the Board of Directors of the Boulevard Club and a member of the Capital Projects Committee that provided input and guidance on the design and construction of the Club's West Wing rebuild. David supports a number of charities, including Juvenile Diabetes Research Foundation and Women's Shelters Canada.

His practice is transaction-based with a particular emphasis on project financing, bank and asset-based lending, high-yield debt and restructurings with banking and finance components. David advises lenders, borrowers and sponsors on complex domestic, cross-border and international financings. David has deep knowledge of financing issues relevant to renewable energy, infrastructure and mining.

David's representative work includes acting for: Fiera Private Debt (formerly IAM Private Debt), as lead counsel, in connection with various infrastructure and corporate financings across Canada; CE Mining in connection with a financing of Rambler Metals & Mining; SkyPower Global in connection with a holdco financing in relation to its seven Ontario RESOP solar park projects and its completion of 5 concurrent refinancings totalling US$230 million by Nomura Securities International for these projects; Hub International in connection with its US$5.06 billion cross-border refinancing from Morgan Stanley; Conuma Resources in connection with its US$250 million cross-border refinancing, comprising a US$200 million 10 per cent senior secured notes offering and a US$25 million credit facility;
CJF Capital Partners and SUSI partners in connection with cross-border, non-recourse third party project financings of two energy storage projects in Ontario totalling 12MW; CEDA/OMERS in connection with its C$125 million credit facilities with Bank of Nova Scotia; Hudson Resources in connection with a multi-lender project financing in Greenland; Mandalay Resources in connection with US$40 million HSBC credit facilities; Ganfeng Lithium Co, Ltd in connection with the US$355 million financing of Cauchari-Olaroz lithium project in Jujuy, Argentina; Canaccede Financial Group in connection with its US$75 million financing and several distressed debt portfolio acquisitions from Canadian banks; Ridgeback Resources in connection with its C$400 million senior credit facilities and US$40 million second lien notes; OMERS/Golf Town/Golfsmith in connection with DIP credit facilities from Antares Capital; Eurasian Resources Group in connection with US$3.1 billion in credit facilities from VTB Bank; KKR and Jefferies Finance in connection with the US$700 million refinancing of Preferred Sands; Wells Fargo, PNC Bank, MidCap Business Credit, Sienna Lending, People’s Bank, Provident Bank and Citizen’s Bank on various ABL/commercial finance transactions; various leading international and US law firms on cross-border financings.

David was admitted to the Ontario Bar in 1997.

LUKAS WYSS
Walder Wyss Ltd

Lukas Wyss is a partner in the banking and finance team of Walder Wyss. He advises banks, insurers and other companies in connection with a broad variety of finance transactions, capital market transactions and, more generally, in regulatory, securities and corporate law matters. In finance, he focuses on corporate debt finance, leveraged finance, acquisition finance, asset finance (including real estate finance) as well as structured finance and securitisation. He advised banks in some of the largest acquisition finance transactions in 2014 and 2015.

Mr Wyss was educated at Zurich University and Lausanne University (lic iur 2000) and Columbia University, New York (LLM 2006, James Kent scholar). He was admitted to the Zurich Bar in 2002. Before joining Walder Wyss in 2007, he gained working experience as a district court law clerk (Meilen, ZH) and as attorney at major law firms in Zurich and New York.

Mr Wyss speaks German, English and French. He is registered with the Zurich Bar Registry and admitted to practise in Switzerland.

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Xiong Yin is a partner at Beijing Tian Yuan Law Firm. Before returning to China, Xiong Yin practised law for over five years (1994–1999) at the Chicago Office of Baker & McKenzie. He is admitted in the United States as a member of the State Bar of Illinois, and is also admitted in China.

Xiong Yin has practised in the areas of corporate law and international investment including FDI, domestic and overseas investment, mergers and acquisitions, reverse takeovers (RTO) and overseas listing, corporate financing, restructuring, venture exploration and mining, clean energy and natural resources, technology licensing/transfers, education and commercial arbitration.
Xiong Yin was awarded an LLM degree from Harvard Law School in 1994. When working full-time at Baker & McKenzie’s Chicago Office, he received a JD degree in 1998 from the Illinois Institute of Technology (IIT) Chicago-Kent College of Law. Xiong Yin received a bachelor of law degree in 1984 and a master of law degree in 1987 from Beijing University. He was a PhD candidate in international law at Beijing University before he went to the United States in 1989 to do research and study at the University of Maryland and at Harvard Law School.

İPEK YÜKSEL
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Ms İpek Yüksel graduated from Istanbul University School of Law in 2014. She received her master’s degree (LLM) from the Istanbul Bilgi University in 2019 and was admitted to the Istanbul Bar Association in 2015. She joined Kolcuoğlu Demirkan Koçaklı in 2018. She has experience in mergers and acquisitions, capital markets and finance transactions, including acquisition finance, project finance, syndicated loan facilities and ECA-backed loan facilities. She provides legal advice to both domestic and foreign companies acting in a wide range of sectors, and to banks and financial institutions on numerous M&A and project financing transactions.

JOSÉ FÉLIX ZALDÍVAR
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José Félix Zaldívar joined Uría Menéndez in 2010, and he has been a senior associate since 2018. Between January and December 2013, he was based in Uría Menéndez’s office in São Paulo (Brazil). From September 2018 to August 2019, José Félix joined the M&A team at Cravath, Swaine & Moore LLP in New York as a foreign associate attorney.

José Félix has over eight years of experience advising on M&A and finance transactions, both national and cross-border. He has also advised creditors and debtors on restructuring the debt of some of Spain’s biggest companies. For the past six years, he has been very active in advising sellers and buyers in transactions involving non-strategic assets of financial institutions.
Appendix 2

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Milbank LLP

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW
Mark F Mendelsohn
Paul, Weiss, Rifkind, Wharton & Garrison LLP

THE ASSET MANAGEMENT REVIEW
Paul Dickson
Slaughter and May

THE ASSET TRACING AND RECOVERY REVIEW
Robert Hunter
Edmonds Marshall McMahon Ltd

THE AVIATION LAW REVIEW
Sean Gates
Gates Aviation LLP

THE BANKING LITIGATION LAW REVIEW
Christa Band
Linklaters LLP

THE BANKING REGULATION REVIEW
Jan Putnis
Slaughter and May

THE CARTELS AND LENIENCY REVIEW
John Buretta and John Terzaken
Cravath Swaine & Moore LLP and Simpson Thacher & Bartlett LLP

THE CLASS ACTIONS LAW REVIEW
Camilla Sanger
Slaughter and May

THE COMPLEX COMMERCIAL LITIGATION LAW REVIEW
Steven M Bierman
Sidley Austin LLP

THE CONSUMER FINANCE LAW REVIEW
Rick Fischer, Obrea Poindexter and Jeremy Mandell
Morrison & Foerster

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