

## Creation and enforcement of a right of pledge over Dutch shares

### 1. Introduction

This issue of Loyens & Loeff Tokyo Newsletter Legal considers the creation and the enforcement of a right of pledge over shares in a private limited liability company (besloten vennootschap - "B.V.") in the Netherlands. The issues described below are relevant for banks as well as for companies which find themselves in an enforcement situation (either as shareholder or as the subject of the right of pledge).

### 2. Creation of a right of pledge over Dutch shares

#### 2.1 General

The creation of a right of pledge over shares in a B.V. requires a notarial deed (notariële akte) to be executed by a civil law notary practising in the Netherlands. The parties to the deed will in any event include the pledgor and the pledgee (often a single bank acting as security agent for other creditors) and usually also the company whose shares are subject to the right of pledge (the "Subsidiary"). In case the Subsidiary is not a party to the deed, the right of pledge can only be enforced after (i) the Subsidiary has acknowledged the right of the pledge, (ii) the deed of pledge has been served on the Subsidiary or (iii) the Subsidiary has registered the right of pledge in the shareholders' register. A right of pledge over shares needs to be recorded in the shareholders' register of the Subsidiary. However, this is not a constitutive requirement for the creation of a right of pledge over shares. The right of pledge will be validly created even if it is not registered in the shareholders' register. Registration may be relevant, inter alia, as regards the effectiveness of the right of pledge against third parties and the Subsidiary.

#### 2.2 *Is a pledge/transfer of voting rights permitted?*

The articles of association (statuten) of a Subsidiary might provide for an exclusion of the possibility to create a right of pledge over the shares of such Subsidiary. Hence, it is important to check whether the creation of a right of pledge is permitted. If not, the articles of association of the Subsidiary will need to be amended before the creation of the right of pledge. Also, it is generally desirable that the articles of association provide for the possibility to transfer the voting rights attached to the shares. The voting rights will transfer to the pledgee, if the deed of pledge provides for such transfer and (i) the pledgee is a person to whom the shares can be freely transferred or (ii) the creation of the right of pledge has been approved by the corporate body of the Subsidiary appointed to do so in the articles of association.

In practice the parties will usually make the transfer of voting rights subject to (i) the prior occurrence of a 'voting transfer event' (a voting transfer event is normally defined as a default under the credit agreement) and (ii) notification of such voting transfer event by the pledgee to the pledgor and the Subsidiary. The transfer of the voting rights attached to the shares can be a way for the pledgee to obtain control over the Subsidiary.

### *2.3 Who is entitled to dividend payments?*

A right of pledge over shares also includes the right to receive dividend payments from the Subsidiary. Hence, the right to receive dividend payments transfers from the pledgor to the pledgee. However, the deed of pledge often provides that the power to collect dividends remains with the pledgor until the occurrence of an event of default and notification thereof by the pledgee to the pledgor.

## **3. Enforcement of a right of pledge over Dutch shares**

### *3.1 General*

Upon a default of the pledgor under the obligations secured by the right of pledge, the pledgee is in principle entitled to enforce its right of pledge over the shares. Following the enforcement of the right of pledge, the pledgee has priority in taking recourse on the proceeds of the foreclosure. The question whether the debtor is in default needs to be determined under the law applicable to the obligations secured by the right of pledge (e.g., under English law, if the credit agreement is governed by English law).

In the Netherlands, a right of pledge over shares can be enforced in three ways: (i) a public sale, (ii) a private sale with court approval, or (iii) a private sale with the consent of the pledgor.

#### *3.1.1 Public sale*

Dutch law assumes that where a right of pledge is enforced by the pledgee, the pledged assets will be sold by means of a public sale in accordance with local customs and usual terms. This is intended to protect the interests of the pledgee and other creditors. The underlying assumption is that in case of a public sale the pledged assets will be sold to the highest bidder and thus an objective and fair price is generated. It prevents the pledgee from conspiring with a buyer and hence being able to prejudice the interests of the other creditors. Although the pledgee is in principle not permitted to appropriate the pledged assets, he does have the right to make an offer for the shares at a public sale.

In practice it is not common for shares in a B.V. to be sold by way of a public sale, as shares in a B.V. are subject to certain mandatory transfer restrictions. Dutch law provides that the applicable transfer restrictions have to be taken into account with respect to the enforcement of a right of pledge over shares. Furthermore, there is no open market on which the shares in a B.V. can be traded, which means that a public sale is not an obvious course of action. In addition, a buyer of shares would usually perform due diligence to obtain comfort as to the value of the business, particularly as the legal provisions on non-conformity cannot be invoked by the buyer in a foreclosure sale. Also relevant is that, in case of a public sale, the information provided in the due diligence process (including confidential information) will become public knowledge and therefore potentially available to competitors. Consequently, it can be questioned whether a public sale of shares in a B.V. will always generate the highest possible proceeds.

### *3.1.2 Private sale with court approval*

Both the pledgor and the pledgee have the right to submit an application for approval of a private sale of the pledged shares at the district court. Typically, the deed of pledge will exclude the pledgor from any rights to submit such application.

Following the submission of the application, the court will set a date for a hearing of the pledgee. It is not required to hear the pledgor or other interested parties. The deed of pledge usually provides that the pledgor does not have to be informed of the hearing by the court. Notwithstanding the foregoing, the court usually does inform the pledgor of the planned hearing date or will instruct the pledgee to inform him.

In assessing the application for approval of a private sale, the court will consider (i) whether the pledgee has already found a potential buyer who has made an unconditional offer for the shares, (ii) whether such offer is fair on the basis of independent valuation reports/fairness opinions, and (iii) whether the potential buyer is creditworthy. The court can reject the application, if the pledgor is able to show that the price offered for the shares is less than market value (for example by proposing an alternative buyer offering a higher price). Merely submitting an expert report indicating a higher value will generally not be sufficient. It is not self-evident that the court consents to a sale of the shares to such alternative buyer, as such alternative bid does not form part of the original application. In order to get the alternative bid approved by the court, a further application must be submitted. Finally, the court's decision to approve or reject the application requesting for the sale of the shares is in principle not open for appeal.

### *3.1.3 Private sale with consent of pledgor*

The pledgor and pledgee can also agree to sell the shares without obtaining prior consent from the court. This is not possible until after the pledgee has become entitled to enforce its right of pledge over the shares. Any provision in a contract stating otherwise is null and void. In other words, the pledgor is not entitled to give its consent at the time of the vesting of the right of pledge. This provision is intended to protect the pledgor.

If the shares are subject to other security rights (such as a second ranking right of pledge) or attachments, the prior consent of these parties is required in case of a private sale with consent of the pledgor. In order to obtain such consent, the pledgee will reasonably have to show that a fair price will be paid for the shares. A successful recent example of a private sale with consent of the pledgor is the foreclosure sale of the shares in a Dutch company active in the gambling industry, where the lenders and the borrower/pledgor agreed on a sale of the subsidiaries' shares. The sales process was concluded promptly and in the manner envisaged by the parties.

### *3.2 Transfer and exercise of voting rights*

As mentioned in paragraph 2.2, a deed of pledge usually provides that the voting rights attached to the shares only transfer to the pledgee upon the occurrence of a voting transfer event. Although the pledgee might not need these voting rights in order to commence enforcement, being able to exercise the voting rights can be important for the pledgee from a practical point of view. The pledgee would for example be able to replace one or more of the directors of the Subsidiary, e.g., if the board is not willing to cooperate with a group restructuring.

Transferring voting rights does have certain disadvantages. For example, upon such a transfer (i) shareholder resolutions no longer possible may be taken outside of a meeting, which could give rise to practical problems, (ii) the pledgee (as the person having obtained the voting rights) would have to take decisions relating to the Subsidiary to which he is not equipped or authorised, particularly if he is acting as security agent in a bank syndicate, and (iii) the pledgee would involved in determining the policy of the Subsidiary could under certain circumstances create liability risks (the risk of being liable as a policy maker).

### *3.3 Valuation of the Subsidiary*

The valuation of the Subsidiary is an important factor to take in consideration, regardless of whether the shares are sold privately with prior court approval or with the consent of the pledgor. Dutch law does not provide rules regarding the method of valuation. If the pledgee (or sometimes the pledgor, to the extent it has not been excluded from doing so) requests the consent of the court for a private sale, the court needs to be of the opinion that no higher price can be obtained by a public sale. In order to demonstrate this, the applicant will at least have to provide the court with one (or more) valuation reports or fairness opinions. A fairness opinion will be prepared by an external financial expert and can be costly.

The “Schoeller Arca” case is a recent Dutch court case in which there was a disagreement on the valuation of shares and the court was requested to consent to the enforcement of a right of pledge over these shares by means of a private sale of the pledged shares. Magnum-SAS Acquisition B.V. (“Magnum”) received from several lenders a senior facility and a subordinated bridge facility. Citibank acted as security agent for the lenders and was, in that capacity, the holder of a right of pledge on the shares in Schoeller Arca Systems Services B.V. (“Schoeller”).

Magnum breached its obligations under the senior facility and Citibank announced that it was going to enforce its right of pledge on the shares by means of a private sale. Before the court, parties disputed the valuation of the shares. Various valuation reports were submitted to the court. Eventually Citibank, at the request of the senior creditors, sold the shares to a buyer (an affiliated party), subject to the condition precedent of prior court approval.

One of the bridge lenders (which provided a portion of the subordinated facility) objected to the application made by Citibank. It argued that the proposed private sale as opposed to a public sale of the shares would render the receivables resulting from the subordinated bridge facility worthless. In addition to the bridge lender, one other potential buyer also objected to the application, stating that its own bid represented a higher price for the shares.

The court considered that it was likely that in this case a private sale of the shares would lead to a higher price than a public sale would, particularly in view of the structure and complexity of the group and the need for further financing for the company in which the shares were going to be sold. Furthermore, the court considered that it is at the pledgee's sole discretion to determine if and when it wishes to enforce its right of (obviously provided that it has the right to commence such enforcement action). In other words, the pledgee can proceed to enforce, even if this is prejudicial to the interests of other creditors.

Although the alternative buyer's bid was not submitted until after the conclusion of the investigations at the hearing, the court did take this bid into account in determining whether the bid proposed by Citibank was the best bid. The court determined that the alternative bid was conditional (and therefore not realistic) and that it had also not been established that such bid was the best achievable bid. The court therefore granted the pledgee permission for a private sale. As a result, the subordinated bridge lenders had to write off their claims against the Schoeller Arca group.

#### **4. Conclusion**

The enforcement of a right of pledge over shares in a B.V. can be effected in various ways. A private sale of the shares (with or without court permission) would be most practical. In case of a private sale with court permission, the court should consider whether the proposed bid is realistic (in other words, whether such bid would lead to the highest possible proceeds). A private sale with the consent of the pledgor would be less time-consuming, although it does require the cooperation of other security holders. It should be taken into account that any consent to such sale between the pledgee and the pledgor prior the occurrence of an event of default by the pledgor is void under Dutch law.

In the event of a disagreement on the valuation, the pledgee (and where applicable the pledgor) will often wish to obtain court approval for the proposed sale. The Schoeller Arca case shows that it is very important for an interested buyer to join forces with those who hold the first right of pledge, as it will be the pledgee who will have control over the enforcement process.

## Colophon

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