Buyer beware: differences between Dutch and US/English mergers & acquisitions

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Introduction

As the focus of international investments has slowly shifted towards sustainable development through synergy (of acquired assets) and continued involvement of the investors, extensive M&A contracting has become even more crucial (and prevalent). As a result, international investors now, more than ever, have to account for differences between jurisdictions in the process of closing their deals.

The Netherlands has long been a fan favourite of American and British investors (with the US bringing in the big bucks, as the country with the largest yearly monetary involvement in the Netherlands[1]). Therefore, differences between the laws of the Netherlands and the UK and between those of the Netherlands and the US (mostly Delaware) are highly relevant to large numbers of investors seeking to acquire companies and assets in the Netherlands. This article sets out some of the differences between these jurisdictions that are especially relevant during specific aspects of M&A transactions. This article touches on some of the differences that might be considered of consequence. The article is not in any way intended as an extensive list of cautionary tips, but our lawyers at DVDW are always willing to help foreign companies and investors with their questions relating to Dutch M&A transactions and related legal matters (both national and international) in general.

1. https://longreads.cbs.nl/nederland-handelsland-2021/buitenlandse-investeringen-en-multinationals/

The pre-contract phase

Precontractual liability

Most western jurisdictions, if not all, allow a generous amount of freedom when it comes to negotiations and contracting. It is the "liberal" view (referring to John Locke, not to any political meaning of the word), which is still held in most western countries, that each individual is entitled to as much freedom as possible, in so far as that freedom does not diminish the freedom of others. This means that, if the parties so decide, they may even stipulate extraordinary provisions within a contract, which each party may then enforce, so long as the provision does not impose on others. A general principle related to this "freedom to negotiate" is that parties are also free to break off the negotiations and say "no". However, in some jurisdictions a party might face consequences if they choose to do so. The Netherlands is one such jurisdiction.

UK/US doctrine

In the United Kingdom, under English law (the common law), there is no general doctrine of good faith.[2]

2. See: A. Calvert, J. Bond, M. Houlihan, "Good Faith in English Contract Law", Bracewell LLP Update.

Therefore, parties are under no obligation during their negotiations to act in good faith. There are certain exceptions to this principle (such as if a good-faith clause is expressly imposed by the wording of the contract), but such exceptions generally only come into play if and when the parties have actually entered into an agreement. During the negotiations, either party is (at least usually) free to pull the proverbial plug, without any liability towards the other party.

In the US, the general principle is similar: any party is free to negotiate a contract without being liable for failure to reach an agreement. However, a party may be liable for the other party's loss or damage if the first party breaks off the negotiations in bad faith ("culpa in contrahendo"). This implies that there is an obligation for the parties to negotiate in good faith. An example of acting in bad faith would be to continue to negotiate despite having no intention to actually reach an agreement, while the other party is under the (justified) assumption that an agreement will be reached.

Dutch doctrine

Dutch precedent on precontractual liability more closely follows the US doctrine than the UK doctrine, as the parties may be held accountable for any loss or damage incurred

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as a result of broken-off negotiations. However, Dutch case law has developed in such a way that liability of either of the parties (and in particular the exiting party) has become more and more difficult to prove.

Currently, the measure under which pre-contractual liability can be established was defined by the Dutch Supreme Court in its judgement in the case CBB/JPO as follows (rough translation):

> *"As a benchmark for assessing the obligation to pay compensation in the event of broken-off negotiations, each of the negotiating parties – whose conduct must be determined in part by the other's justified interests – is free to break off the negotiations, unless this would be unacceptable on the basis of the other party's justified confidence that an agreement would be concluded or on the basis of other circumstances of the case."*[3]

Any ruling on such liability would have to consider a "strict and restrained standard", as ordained by our Supreme Court.

3. Dutch Supreme Court's judgment of 12 August 2005, ECLI:NL:HR:2005:AT7337 (CBB/JPO).

Nevertheless, it is still possible to claim damages as a result of broken off negotiations under Dutch law (in accordance with the development of precedent under Dutch case law). This makes the Dutch pre-contractual doctrine much different from its UK counterpart, and still more lenient than its American counterpart. Caution is advised, especially in the later stages of negotiations as the opposing party's confidence that an agreement will be concluded becomes increasingly more justifiable.

The choice of pricing mechanism

Once the parties enter into full-fledged negotiations for their M&A deal, they will have to decide how they will establish the price of (the assets of) the target company, i.e. they need to decide what pricing mechanism they wish to use in their agreement.

Two of the most common types of pricing mechanisms are: (i) the Locked Box Mechanism (or "**LBM**"), where the company is bought as it was at a specific moment in time against a set price, with limited items being considered "leakage", which may then affect the purchase price, and (ii) the Completion Accounts Mechanism ("**CAM**"), where accounts are drawn up, which accounts, or usually more specifically the revenues/

profits established according to those accounts, determine the purchase price at the moment of completion.

Advantages and disadvantages of the LBM

The main reason for sellers to ask for the LBM to be used, is that the LBM provides greater price certainty. The price is already “fixed” prior to closing (and can only change if the seller actually enriched themselves by depleting the company’s funds and diverting them into their own pocket). As the price is pretty much set, the odds of disputes arising in connection with the purchase price are slimmer, meaning that the seller does not have to deal with (or at least prepare for) much litigation.

As no post-account amendment to the purchase price takes place, the LBM produces far less complicated SPAs. The mechanism itself is far less complicated (leakage items are much easier to establish than completion accounts). The LBM therefore allows for more cost-effective negotiations (about a less complicated agreement). It also often saves time after signing, compared with the time that is usually required to establish the closing accounts if the CAM is used.

On the other hand, a fairly substantial disadvantage of the LBM, as will also be explained in the following paragraph,

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is that US investors are not used to this type of pricing mechanism. Therefore, US investors can be more skittish when it comes to implementing this system in their deals.

Furthermore, the LBM is difficult to use in carve-out deals, because leakage items (money leaving the company that the sellers have to pay for) are more difficult to determine for target companies that are not (or at least not entirely) financially separate from any parts of the business that the transaction does not include.

Buyers will need to deal with a degree of uncertainty when opting for the LBM. The LBM creates some uncertainty about the period between the "Locked Box Date" (the reference point for the sale) and the closing date. If the operations yield a profit during this period, this works to the buyer's advantage. However, if the operations produce a loss, that puts the buyer at a disadvantage. Usually this can be solved by "if and when" clauses, whereby it is common for sellers to demand interest compensation, if they foresee profit between signing and closing.

Prevalence of the LBM in the Netherlands

Whereas parties form the Netherlands frequently choose the LBM, parties from common-law jurisdictions (mostly US-based investors) generally prefer the CAM. There are several reasons for this difference in preference:

i The M&A practice in the US has traditionally used the CAM. Lack of familiarity with the LBM and its benefits means that US investors are usually not too keen on using it. One of the reasons why the LBM has never taken off in the US can be found in the 2008 financial crisis and subsequent developments. During the crisis, investors were looking for safe assets to invest in (the "flight-to-quality"), and the scarcity of safe companies created a seller-friendly negotiating environment (i.e. the seller was in a stronger bargaining position). Because the US market was unfamiliar, or at least not sufficiently familiar, with the LBM at the time, they started to lag behind other countries in their integration of this mechanism in more M&A deals.

ii As a consequence of the common-law system in the US, any form of contracting that is not used as often as other methods is considered a risk. As precedent (through case law) has had less time and fewer cases to develop, the risks related to the use of the LBM are less clearly defined. Using the LBM therefore creates a greater risk of litigation

(as lawyers will be more unsure about their odds in the courts). Disputes related to unauthorized leakage, for example, might create the possibility of prolonged litigation. The LBM would need to be brought out of its legal infancy in order to become a more reliable tool for US investors. While the risk of litigation can, of course, be diminished by clever drafting and other forms of dispute resolution, it should be noted that the LBM does indeed lower the likelihood of disputes arising from purchase price determination (which in turn lowers the odds of litigation). As such, there are pros and cons to the LBM from a risk mitigation perspective.

iii Another reason why the LBM is less prevalent in America is the steady increase of carve-out deals (i.e. deals where part of the company is not acquired). The LBM is less suitable for these type of deals: it complicates the process of determining leakage (money that should have stayed in the company), as the company might share its current accounts and other accounts with parts of the business that are not being sold.

Letters of intent and merger control regulation

Once the parties have agreed on a pricing mechanism (and, in the case of LBM deals, once a preliminary price has been established), the parties will often want to sign a letter of intent (also called a “head of terms” or “memorandum of understanding”), as a token of being formally committed to actually reaching an agreement. Parties sometimes believe that signing a letter of intent makes an exiting party more likely liable for loss or damage (and some even believe that the terms are binding).

Under Dutch law, however, a (well-drafted) letter of intent is not binding, at least not fully. It might contain confidentiality / exclusivity / non-compete undertakings (or provisions) that are binding, but a letter of intent itself does not create obligations to either sell or purchase, in and of itself.

In the UK, letters of intent can be used to explicitly state the obligation for good faith negotiations, whereas such a statement is not required in the Netherlands.
Caution is required when drafting the letter of intent (especially for foreign investors): generally, Dutch letters of intent contain conditionality clauses (stating that any future agreement is contingent on, for example, the results of due diligence investigation or a satisfactory outcome of negotiations). Those clauses are included in the letter of intent to ensure that there is still room for negotiation, and that the parties signing the

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letter of intent are not liable (or at least not immediately) if they exit while the negotiations are ongoing (as the clauses create a viable defence for the leaving party if litigation ensues).

Before drawing up a letter of intent, the parties should be aware that the European Union has numerous laws related to merger control. Merger controls, or anti-trust filing/approval requirements, also exist in the Netherlands, and the thresholds for mergers that are required to file for approval are relatively low (especially in the healthcare sector). In the UK, this regime of anti-trust filings is voluntary (even though it might be advisable to make a protective filing if the transaction potentially requires clearance), but in the Netherlands it is not. If the proper filings are not made, the buyer (not the seller) could incur a substantial fine. And it is even possible (though extreme) that the entire deal is nullified for failure to observe such regulations.

Contractual terms

The parties' intentions in the construal of contracts

Once the parties have survived the pre-contract phase, have drawn up (and signed) a letter of intent and made it past whatever anti-trust filings were required, the parties will usually start to negotiate the contractual terms of the SPA.

In the UK (and to a certain extent the US), the wording of the contract creates obligations and rights for the parties, and in court proceedings the text is the only factor (or almost the only factor) that is given any consideration.

In the Netherlands, the courts (and the law) have a much broader interpretation of contracts, in which not only the literal text is important, but also the parties initial understanding as well as their intentions and expectations at the time of agreeing to the contract. This (now standard) principle of Dutch law is known as the Haviltex principle.[4] Even if a particular obligation is not explicitly included in the contract, it might nevertheless exist (that is to say a court could enforce that obligation), if the court considers that the obligation falls within the reasonable interpretation (or scope) of the contract (taking into account what the parties expected of each other).

It is precisely this principle governing how contracts are construed that makes the preamble (i.e. the recitals or "whereas clause") more important in the Netherlands than it is in the UK, and potentially more important than it is in the US (or at least in certain US states). The recitals describe the parties' intentions, and those intentions in turn colour the rest of the agreement. It is therefore also advisable to draft the contract in such a way that, when it comes to provisions that could be interpreted in multiple different ways, those provisions are carefully constructed to include wording that sets out the parties' intentions.

Warranties and representations

Most SPAs (whether drafted using the CAM or the LBM) contain warranties and representations by the sellers, which might give the buyer the right to claim compensation for loss or damage if those warranties later prove to be untrue. In the US and the Netherlands, these statements are generally referred to as "representations and warranties", whereas lawyers and dealmakers in the UK will often resist referring to them as such (since defining them as such will potentially widen the scope of legal recourse available to the buyer against the seller beyond the contractual recourse that the buyer already has).

As explained above, the literal wording of the contract (and contractual recourse) is paramount in the UK, where representations and warranties are extensive and detailed.

4. Dutch Supreme Court's judgment of 13 March 1981, ECLI:NL:HR:1981:AG4158 (Haviltex).

As Dutch contracts are construed according to standards of “reasonableness and fairness”, representations and warranties in the Netherlands are often drafted to be vaguer than they would be in the UK, so as to cast a wider net of situations wherein they would (reasonably) apply.

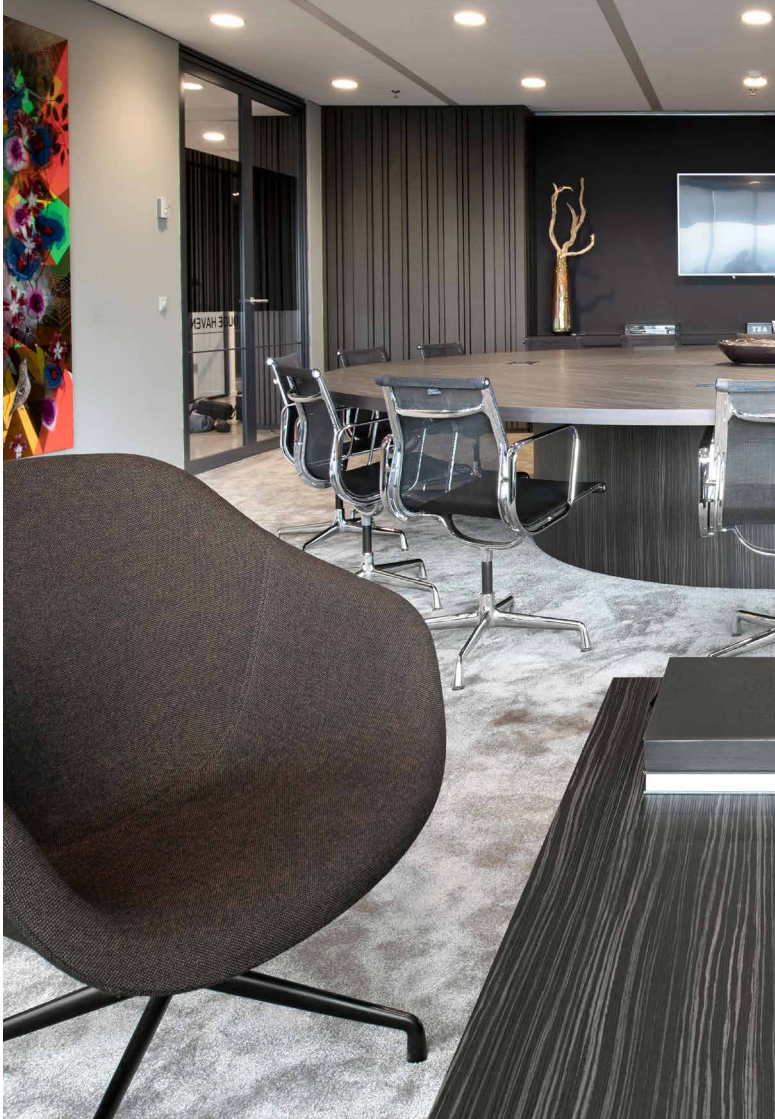
Reasonableness and fairness

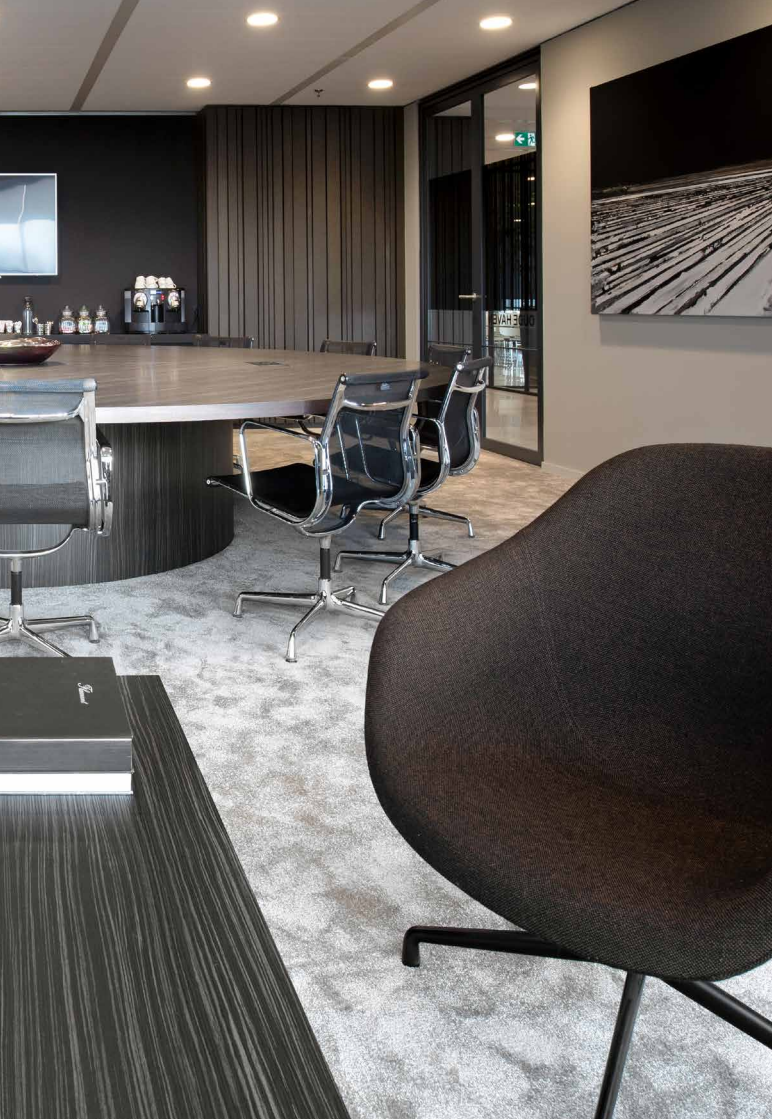
Involvement of employees

The Netherlands (as many European countries) has long attached great importance to protecting the ‘common man’. As such, for example (and in certain cases), before a company enters into an M&A agreement it must first consult its employees (that is to say, an employee representation committee or works council). These committees/councils have mandatory rights of information/consultation. Therefore, employee engagement should be factored into any M&A process in the Netherlands. Furthermore, strict employment regulation protections are in place (within the entire EU) that may complicate the purchase, especially as employees of the target company will automatically transfer to the buyer (which is not always the case in the US).

Reasonableness and fairness

The protections under Dutch law, for smaller contracting parties in particular (such as consumers), extend further





than merely considering the parties' intentions when interpreting a contract (and its implications). Provisions that were agreed might be judged to be null and void if the court considers them to be "unreasonable and unfair". This has an enormous impact on the freedom of contract described in the first section of this article, and it is not always possible to contractually circumvent this principle (i.e. the parties may not explicitly stipulate that they will not or cannot argue the unreasonableness of provisions in legal proceedings).

This general principle (which is widely accepted and applied in the Netherlands) limits the contracting powers of some (often large) parties. What foreign investors often find frustrating about this principle is that it makes contracting a risky business that carries numerous unknowns (although any agreement comes with its own risks, even if the UK's system is implemented and all the various obligations need to be specified in its wording). Litigation becomes less straightforward, as do negotiations. However, the principle in fact often simplifies the negotiating process, because the parties are assured that, even if the contract does not contain every single term necessary to cement their positions, they will still have some degree of protection under Dutch law. Furthermore, the principle of

reasonableness and fairness only really comes into play if a dispute arises about (the interpretation of) the actual contract and only after the deal is closed (if and when litigation ensues).

Protection against claims through disclosed information

Once a deal is finalized, it is possible that disputes will ensue. Such disputes are often related to the representations and warranties given by the seller (or sellers). US and European (and by extension Dutch) parties to transactions are moving closer to each other in terms of their views on the influence of due diligence and disclosed information on transactions. In the Netherlands, it is common practice to include all the information that is disclosed during due diligence under the heading “disclosed information”. This implies that the buyer can no longer bring any claims on grounds of information that was, or should have been, known to them.

Unlike Dutch parties, US parties are familiar with a practice in which it is often still possible to bring claims based on information that was already known to buyers. To this end, “pro-sandbagging” clauses are included in sale and purchase agreements. These clauses have the effect that buyers can be indemnified for a breach of the agreement, even if they were already aware of the breach in question before closing. The popularity of such clauses is declining in America, but they are still included in some sale and purchase agreements. In 2006, pro-sandbagging clauses were included in 50% of American transactions; in 2021 this was still 29%.

These clauses are rarely encountered in the Netherlands. Where they do occur, they mainly relate to fundamental warranties. If the buyer detects a breach (or a potential breach) before closing, this is usually also dealt with before closing. This can be given shape by including an indemnity or by incorporating the financial risk into the purchase price. Pro-sandbagging clauses will therefore be difficult to negotiate when dealing with a Dutch party.

Instead, Dutch M&A contracts usually contain clauses that explicitly rule out pro-sandbagging. Furthermore, given the Dutch principle of reasonableness and fairness (described in the previous section) a court will likely rule that a provision stating that a buyer may bring a claim if a particular warranty is untrue, but the buyer is aware that it is untrue, is null and void.

It has become increasingly important to specify the extent of protections under the warranties. Phrases such as “to the seller’s best knowledge” or “other than has been fairly disclosed” are becoming more and more commonplace.

Summary

Dutch M&A practices differ from those in the US and the UK. To comment on each aspect and difference in every step of the process would take a lifetime to write down, and would take the reader months to read, if not years.

Therefore, this article contains only some relevant examples of the issues that might come up during an M&A transaction in the Netherlands.

In closing we will toot our firm’s own horn by reminding the reader that our lawyers at DVDW are experts who can guide any party through the trials and tribulations of a Dutch M&A deal, and accommodate foreign investors who wish to learn more about (and benefit from) the differences between relevant laws in the Netherlands and in other jurisdictions. Caution is advised for any foreign investor wishing to enter the Dutch market, but we possess the expertise to help you understand and benefit from the Dutch legal system.

If you have any questions about these topics, please contact *Luitzen van der Sluis*, *Martijn Lenstra* and *Bas Augustijn*.

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