Going Dutch

Mergers & Acquisitions in the Netherlands

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In mergers and acquisitions, the human factor is - with respect to the working relations between directors of the companies involved - in most of the cases a dominant factor. By gaining a thorough understanding of the people, culture, environment and company, potential buyers shall find negotiations more smoothly. And the better an acquirer understands its target company, the easier it will be to manage it effectively.

A humorous Anglo-Dutch translation guide has been making its way around the Netherlands for years. It has three columns: 'What the British say', 'what the British mean', and 'what the Dutch understand'. For example, when a British person says, "Please think about that some more", he actually means: "It's a bad idea. Don't do it". But the Dutch interpretation is: "It's a good idea: keep developing it".

While this is clearly intended to provoke laughter, it points to the fact that even when speaking the same language, the chance for misunderstanding is great. Jokes aside, the reality is that there are subtle differences between what is said and what is heard when negotiating a cross-border deal. These nuances can mean the difference between reaching a fair price or a breakdown in negotiations. Van Diepen Van der Kroef has focused on this multicultural approach for years now. Besides our four German lawyers who are also qualified as Dutch lawyers, we have lawyers with a variety of backgrounds including Chinese, Japanese, Swedish, Portugese, Greek.

In an international transaction, English is often used to draw up the contract, which is subject to Dutch law. Familiar-sounding definitions, formats and wording are used. It is tempting to simply use a standard 'City' format and apply Dutch law to it. But the reality is that Dutch and Anglo-Saxon contract law are dissimilar.

The English law approach to the legal status of written contracts is relatively clear. It is firmly established as a rule of law that parole evidence cannot be admitted as evidence to contradict a written agreement. Therefore, a written agreement is generally considered to be the final word in determining the contractual relationships between parties.

Unfortunately, Dutch law is not so certain, with no equivalent of the common law parole evidence rule. As we will discuss, a Dutch court may draw from a large number of sources when determining the contractual relationship of the parties to an existing written agreement. Therefore, when dealing with a Dutch law contract, special precautions are required to avoid ending up with an agreement that is completely different from the one originally envisaged by the parties involved.

> **"It has become common practice in the Netherlands to perform a due diligence investigation on the target company prior to entering into a purchase agreement"**

When parties enter into negotiations with a view to entering into any agreement, such parties are considered to be in a 'special legal relationship'. This special relationship implies that even during the pre-contractual phase, the parties have to take each other's reasonable interests into consideration. Based on this 'pre-contractual good faith', the parties may not always have the right to unilaterally break off negotiations. The obligations imposed by this 'pre-contractual good faith' are not laid down in legislation, but have been developed in case-law.

Under the Dutch Civil Code, parties to an agreement are obliged to observe the principles of reason and fairness in their relationship. This implies that they are under a duty to take into account each other's reasonable interests when exercising their contractual rights. In case-law, this principle of reason and fairness has been applied to parties who are negotiating an agreement: the pre-contractual phase. Depending on all aspects involved a party can be held liable for terminating the negotiations.

Under common law, if the parties want to have discretion to break off negotiations, such is usually achieved by simply inserting 'subject to contract' in drafts of purchase agreements. However, such 'save harbour' does not exist in the Netherlands. If the parties desire to have discretion to break off negotiations, it is advisable to clearly define what the parties may expect from each other in order to avoid that one party may obtain the justified expectations that an agreement will be concluded. And of course, such should be well documented, which is usually done in a Letter of Intent (LOI). For instance, an LOI may expressly state that (i) it is non-binding; (ii) the parties have sole discretion to withdraw without becoming liable; (iii) the final agreement is subject to satisfactorily due diligence and certain further conditions. However, even such non-binding LOI may not fully prevent a party from obtaining said justified expectations, because the assessment whether the other party has such expectations is a factual assessment made at the time of the break-

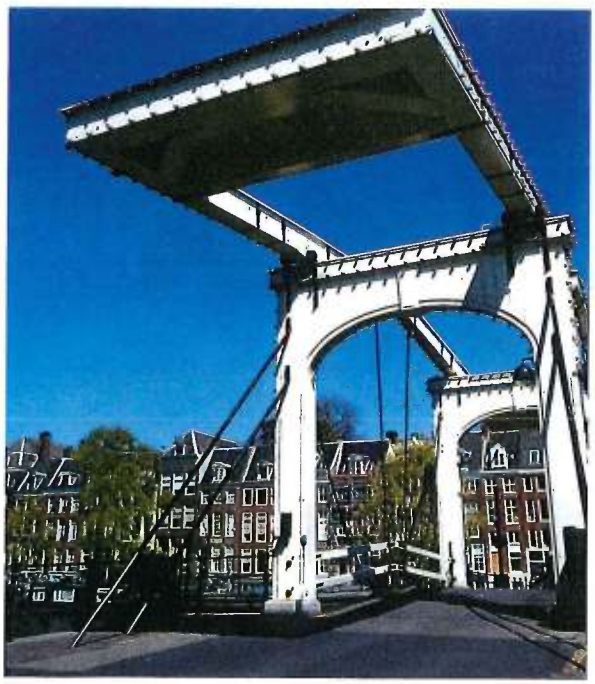
off of the negotiations and not at the time of entering into the LOI.

As in many other jurisdictions, it has become common practice in the Netherlands to perform a due diligence investigation on the target company prior to entering into a purchase agreement. In fact, acquiring a company without performing a proper due diligence investigation may lead to personal liability of the responsible managing directors due to mismanagement. Common law generally expects a purchaser to be responsible for his own investigation, based on the principle of 'caveat emptor', or 'buyer beware'. A purchaser is not likely to be protected when he could have discovered a problem related to the target oneself. In the Netherlands, this is not so clear-cut. The special pre-contractual legal relationship referred to above, which implies that the parties have to take each other's justified interests into consideration during the pre-contractual phase, also plays a role here. In respect of due diligence investigations, the pre-contractual good faith results in a complex relation between the duty of the seller to disclose relevant information and the duty of the purchaser to investigate the target. Unfortunately, it is, again, not laid down in legislation.

The main principles are that: (i) the purchaser is obliged to adequately investigate the target and ask for information on any unclear matters, (ii) the seller is obliged to provide such information and (iii) both purchaser and seller must be able to rely on the correctness of each other's statements. However, as said, the pre-contractual good faith prescribes that each party has to take into consideration the justified interests of the other party. This means that both seller and purchaser are, to a certain extent, obliged to prevent the other party from entering into an agreement based on incorrect assumptions. Therefore, the seller may be obliged to disclose certain information that the buyer never asked for, but that (in the seller's reasonable believe) could be of material interest to the purchaser. The seller has a duty to verify that the purchaser does not have a false impression in respect of the target, notwithstanding the fact that the purchaser has an active duty to adequately investigate the target and ask for information on any unclear matters.

To a certain extent the relation between the duty of the seller to disclose relevant information and the duty of the purchaser to investigate the target are subject to negotiations between the parties. However it is not completely certain whether such arrangement will in all events be enforceable. Therefore, to play it safe, the seller should disclose any information that he believes or should believe to be of material interest to the purchaser, even if the purchaser has not asked for such disclosure. On the part of the purchaser, an extensive due diligence investigation is usually the best option to avoid any unpleasant surprises.

Finally, if a purchaser is, at the time of the entry of the purchase agreement, aware that a certain warranty is untrue, he may not be able to rely on that warranty since a Netherlands court may not assess the representations and warranties in an absolute manner but consider all specific circumstances. If the purchaser is aware that a certain warranty may be untrue, it is advisable to ask for a specific indemnity instead.



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