

ACQUISITION FINANCE IN BELGIUM

ALTIUS' BANKING & FINANCE TEAM CONTRIBUTED TO A JURISDICTIONAL COMPARISON OF INTERNATIONAL ACQUISITION FINANCE. THE VOLUME PROVIDES COUNSEL WITH A FULL INSIGHT INTO THE LAW AND REGULATION ACROSS NUMEROUS JURISDICTIONS. IN THIS ARTICLE JOHAN DE BRUYCKER, HEAD OF ALTIUS' BANKING & FINANCE DEPARTMENT UNTANGLES THE COMPLICATIONS OF DEBT FUNDING REGIMES FOR THE BELGIAN JURISDICTION.

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A. Introduction

B. Methods of Acquisition Finance

- (1) Equity investors
- (2) External lenders
- (3) Debt securities

C. Specific Requirements for Parties that Provide Loans to Commercial Entities

D. Terms of a Senior Syndicated Facilities Agreement

- (1) The right to choose the law that will govern the loan agreement
- (2) Negotiating the contract: precontractual liability
- (3) Negotiating the senior syndicated facilities agreement: letter of intent
- (4) The specific terms: contractual freedom
- (5) Assignment and transfers
- (6) Role of agent and security trustee
- (7) Interpretation of contracts

E. Securing the Acquisition Finance: Restrictions on Giving Security and Guarantees

- (1) Corporate power: limitations included in the memorandum and articles of association
- (2) Corporate benefit
- (3) Financial assistance rules
- (4) The limitations of s 617 of the Belgian Company Code
- (5) Abuse of law ('fraude à la loi')

F. Securing the Acquisition Finance: Possible Security and Formalities

- (1) Security—the general principles
- (2) Mortgage
- (3) Pledges over tangible assets
- (4) Pledges over shares and other financial instruments
- (5) Pledges over invoices
- (6) Pledges over receivables
- (7) Pledges over bank accounts
- (8) Pledges over intellectual property rights
- (9) Pledges over business—'floating' charge
- (10) Guarantees
- (11) Jointly and severally liable debtors
- (12) Specific contractual protection: limitation of recourse
- (13) Set off
- (14) Transfer of financial instruments as security
- (15) Repo-agreement re financial instruments
- (16) Enforcement of Belgian security

G. Intercreditor Arrangements and Subordination

H. Caveat: Lender's Liability

A. INTRODUCTION

As Belgium is a small country and market, the Belgian legislator has sought to make the Belgian laws on credit and financing as attractive as possible to foreign banks, investors, and lenders.

As a result, Belgian law grants the foreign investor or bank a lot of leeway in structuring its acquisition or its financing for that acquisition.¹ The Belgian legislator has only limited the parties' contractual freedom on a small number of issues. Whilst European legislation has inspired or even created some of these limitations, other previous limitations have been softened up by the European directives and regulations.

Notwithstanding the fact that the Belgian laws on acquisition financing were already quite liberal, it is clear from the recent implementation of certain EU directives that the Belgian legislator wanted to go even further down the path towards liberalisation. A good example of this is in the implementation of the collateral directive:² here the Belgian legislator took a very 'bank-minded' position.

In practice, this means that the way in which an acquisition is financed and the facilities agreement are drafted, will not differ much from the UK standard practice.

As a result, the situations and rules that are similar to the UK rules will be discussed briefly in this chapter, while the aspects of acquisition finance and securing the interests of lenders and investors that are specific to Belgium will be discussed in more detail.

B. METHODS OF ACQUISITION FINANCE

(1) Equity investors

According to Belgian scholars the main difference between external lenders and equity investors is that external lenders do not base their actions on a speculative intent. A commercial loan is a commercial act, the purpose of which is to receive compensation for the amount that is made available. In contrast to the form of compensation that equity investors (hope to) achieve, this compensation does not consist of profits which have not been predetermined on the grant of the loan.³

As is the case in the UK, external lenders will partly base their decision on whether or not to provide funds on whether there are sufficient equity investors interested in investing in the company. The fact that equity investors are willing to risk investing in a target company will be a significant element in determining whether external lenders have the confidence to make large sums available.

(2) External lenders

In most cases, the amount of money provided by external lenders will to a large extent eclipse the sums that are made available by the equity investors.

Depending on the amount that is needed to finance the acquisition and on the specific nature of the envisaged acquisition, either one single bank or a consortium or a syndicate of banks will provide the acquiring company with the necessary funds.⁴ Under Belgian law, the banks that participate in such a consortium/syndicate are free to structure their internal relationships in whatever way they wish, save for some minor issues, which are discussed below.

1 Loan agreements are governed by ss 1892–1914 inclusive, which merely state the obvious and from which the parties can deviate in their agreement.

2 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, *Official Journal L* 168, 43–50.

3 G Schrans and R Steennot, 'Algemeen deel van het financieel recht' in *Reeks Instituut Financieel Recht* 5, Intersentia, Antwerp, 2004, 421, no 524.

4 G Schrans and R Steennot, 'Algemeen deel van het financieel recht' in *Reeks Instituut Financieel Recht* 5, Intersentia, Antwerp, 2004, 421, no 524, who define consortium credits in euro currencies or roll-over credits as credit facilities on medium or long term, that can be called upon by the debtor in the form of short term advances which can be renewed on their termination date, which are granted by a consortium of banks that collects the monies from the euro currencies market, and which is denominated in a currency that differs from the currency of the countries where the banks are incorporated.

This sometimes means that the banks will opt for foreign law, eg, English or New York law, to govern their relationships. Apart from the issues discussed below, with a few minor alterations facilities agreements or intercreditor agreements commonly used in the United Kingdom or the USA can be used to govern the legal relationships between the participants in a consortium.

As in the UK, a differentiation is made between senior lenders, mezzanine lenders, asset-backed lenders, and working capital lenders. For the specific characteristics and definitions of these different kinds of lenders, please refer to the chapter on England, as the situation in Belgium is directly analogous to the situation in the UK.

(3) Debt securities

Bonds

Under Belgian law a company can also acquire the necessary funds by issuing bonds⁵. Unless otherwise stated in the articles of association, the board of directors has the right to issue bonds, subject to obtaining the support of the usual majority, unless provided otherwise in the articles of association.

If the bonds are issued by a private placement, Belgian law does not set out the specific rules that have to be followed by the issuer, except for some rules on premium bonds,⁶ ie bonds that are to be repaid at random times and which are either issued below par, repaid above par or both. The company seeking to issue such premium bonds has to comply with the following rules: (i) the bonds have to yield at least 3%; (ii) the premium that is to be paid has to be the same for all similar bonds; (iii) the annuity, including the instalment and the interest has to remain the same throughout the duration of the bond; (iv) all bonds must have the same chance of being repaid, (v) the total amount of the bonds that are issued has to be smaller or equal to the company's capital and (vi) the bonds may not be issued in a non-materialized form.⁷ Non-compliance with these rules may result in criminal liability for the issuer's directors.⁸ Premium bonds are nowadays seldom issued in Belgium.

Documentation issues

If bonds are issued by public placement, a prospectus that has been approved by the CBFA⁹ has to be made available to the public. Under Belgian law an offer will be considered public if a communication is made by the bidder who can be a person/entity who can issue or transfer the securities (or by a person acting on behalf of the bidder) on the Belgian territory to persons, in any form and by any means, presenting sufficient information on the terms of the offer. Any person who receives directly or indirectly a consideration or benefit is considered to act on behalf of the bidder.

The following offers are not considered public if:

- offers made solely to "qualified investors" within the meaning of the Law of June 16, 2006 on Public Offers and to the Admission to trading of Investment Instruments on a Regulated Market (the "Prospectus Law");
- offers made to fewer than 100 persons, other than qualified investors within the meaning of the Prospectus Law;
- offers with a minimum investment of EUR 50,000 per investor;
- offers with a denomination per security of EUR 50,000 or more; or
- offers of a total value of less than EUR 100,000.

⁵ We do not cover treasury notes and deposit notes governed by the Law of 22 July 1991. This type of instruments can be a good alternative for bonds (*obligaties*) but are rarely used for acquisition finance. The most important disadvantages of treasury notes are the fact that a prospectus is needed, high denominations are necessary (minimum EUR 250,000) and the issuer must fulfill very strict financial requirements.

⁶ *Premieobligaties*.

⁷ Belgian Company Code, s 488.

⁸ Belgian Criminal Code, ss 301 and 302.

⁹ The Commission for Banking, Finance, and Insurance.

Status of bond holders in the case of insolvency

Bondholders do not have any specific creditor status; they are treated like any other creditor of an insolvent debtor (*pari passu*) unless if the issuer would have agreed that the bondholders would have a securities interest securing the obligations of the issuer and that the required formalities for such a security have been complied with.

There exist no particular rules on the appointment of an agent who can file a statement of claim on behalf of the bondholders. The general rules of representation, as laid down in the Belgian civil code, apply.

C. SPECIFIC REQUIREMENTS FOR PARTIES THAT PROVIDE LOANS TO COMMERCIAL ENTITIES

Under Belgian law, a banking licence is not required to grant loans to commercial entities.¹⁰ In accordance with the Law of 22 March 1993 on the Legal Status and Supervision of Credit Institutions, a banking licence is as a rule required if bank deposits or other refundable monies are accepted from the Belgian public.

D. TERMS OF A SENIOR SYNDICATED FACILITIES AGREEMENT

(1) The right to choose the law that will govern the loan agreement

Under Belgian law, the parties to a senior syndicated facilities agreement are allowed to choose the law that will govern their contractual relations under that agreement, provided that there is a sufficient link between the agreement or the facts and the law that is chosen.¹¹

(2) Negotiating the contract: precontractual liability

The precontractual phase of negotiations is governed by the principles of due care and good faith, limiting the parties' freedom of contract.

Precontractual liability could arise if a party breaks off its negotiations (such as the negotiation of a term sheet or loan documentation) in an unlawful manner. Although the negotiating parties are in principle free to break off the negotiations at any stage and without having to give reasons therefore, a party cannot abuse this right. A party will be deemed to have abused its right if it breaks off negotiations in the absence of a sound reason thereby harming the other party's confidence that the negotiations had been started in good faith or, where the negotiations were at such an advanced stage, that the other party was confident that a contract would be concluded.

Precontractual liability could also arise if a party breaches its duty to duly inform the other party. However, this does not imply that a negotiating party must provide all information which it possesses. A negotiating party is only required to provide the other party with the information which it is deemed to have by virtue of its specific capacity (eg, a banker's professional expertise) and which is assumed to be of such essence or great importance to the other party in assessing its contractual position.

A breach of the duty of due care during the negotiations will result in a party's liability in tort.

(3) Negotiating the senior syndicated facilities agreement: letter of intent

In Belgium, pre-contractual agreements are in principle not binding. However, the difference between an agreement and a pre-contractual letter of intent is not always clear. It is up to the courts to consider the contents of an agreement and the intention of the parties in order to determine whether it is binding. If the parties intend their pre-agreement to be non-binding, they should include a provision unambiguously expressing their intention in this respect.

A term sheet could be held to be binding if it contains all essential elements of the transaction.

(4) The specific terms: contractual freedom

¹⁰ A specific licence is required to grant consumer loans or consumer mortgages.

¹¹ Section 3 of the Convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980, Official Journal L 266, 1–19, or s 98 of the Belgian Conflict of Law Code where this Convention does not apply.

Belgian contract law is constructed on the basis of the freedom of contract. This implies that parties are in principle free to decide upon the coming into existence and the contents of an agreement. The freedom to contract is limited by mandatory requirements, which are divided into rules of public policy and mandatory rules.

The rules of public policy will either forbid certain actions or provisions or will obligate the parties to include certain provisions in the agreement. The parties cannot deviate from these rules of public policy.

As well as the rules of public policy, Belgian law includes mandatory rules, ie, rules that will provide the parties a form of protection that can be waived by the parties as soon as the protection comes into existence, and supplementary rules, ie, rules that automatically fill the contractual 'gaps' that are left open by the parties. In other words, if the parties fail or forget to sufficiently set out certain aspects of the agreement, these supplementary rules will automatically be inserted or presumed to be inserted in the contracts.

The parties can always deviate from the supplementary rules, in certain conditions from the mandatory rules,¹² but never from the rules of public policy.

Except for the prohibition to demand more than six months of interest¹³ to compensate the early repayment of the entire loan or part of it by the borrower, of which it is uncertain whether this is a mandatory or supplementary rule, no mandatory rules exist with respect to commercial loan agreements. One supplementary rule¹⁴ exists regarding the interest that will accrue on the loan, which is discussed below.

There is a rule of public policy that forbids usury.¹⁵ Another rule of public policy forbids the lender to demand interest on interest.¹⁶ Within the framework of acquisition financing, the mandatory requirements and rules of public policy will to a large extent relate to the security interests, eg, the financial assistance rules. Obviously, there exist numerous other mandatory and supplementary rules, and rules of public policy that are not specific to loan agreements, eg, fraud, money laundering, rules of representation, etc. These rules are not within the scope of this chapter.

The principle of freedom of contract is further limited by the general duty of due care. Parties should act reasonably and fairly when negotiating, executing, and performing a contract. The principle of due care sometimes allows the judge to intervene when a party's negotiating position would result in unreasonable contractual provisions for the other party. Such an intervention will of course be impossible if parties are considered to have equal or equivalent bargaining positions.

Belgian contract law is based on the Civil Code, containing the general principles. These principles are interpreted and complemented by case law and legal doctrine. It should, however, be noted that decisions by Belgian courts do not constitute binding precedents.

In practice, the above implies that in the larger acquisition finance transactions, English and New York law documents will be used to govern the position of the parties. Most 'mezzanine mechanisms and techniques' usually applied in the UK, such as stop notice periods, deferred acceleration rights, entrenched senior facilities amendments, etc are also common features in Belgium. It is also possible for a mezzanine lender to appoint a board observer.

For more specific information on the content of these English and New York law documents, please refer to the chapters on England, Scotland, and the United States. The majority of the specific clauses explained in that chapter on England can be used here without amendment. Only a small number of specific provisions would have to be amended to be in line with the Belgian requirements. These issues are discussed below.

Interest

The Belgian Civil Code stipulates that a loan is in principle free of charge. The parties to the loan agreement may however stipulate that the debtor has to pay interest on the monies lent. Given the aforementioned principle the debtor's obligation to pay interest has to be explicitly mentioned in the facilities agreement. The lender must also set

12 Note that a party can only waive the protection that is given by a mandatory rule, as soon as he can invoke this protection.

13 Calculated on the amount that was repaid before it became due.

14 Not taking into account the prohibition to demand more than six months of interest, calculated on the amount the borrower repaid before the date it became due, to compensate the early repayment of the entire loan or part of it by the borrower, of which it is uncertain whether this is a mandatory or supplementary rule.

15 Belgian Penal Code, s 494: see below.

16 Belgian Civil Code, s 1154: see below.

out the interest rate in a clear way. If the agreement stipulates that interest will have to be paid but the applicable interest rate is not mentioned or unclear, the legal interest rate will apply.¹⁷

The third paragraph of s 1907 of the Belgian Civil Code stipulates that in the case of late payment or non-payment, the interest that will accrue on the unpaid amount may not be higher than the usual interest plus 0.5% per annum. Although this section is still included in the Belgian Civil Code, the majority of legal scholars believe that the parties can contract out of this section.

Section 1154 of the Belgian Civil Code forbids the lender to capitalize the interest that has accrued for at least one year on the monies that were lent and to demand interest on that capitalized interest, save when the lender has served the borrower with a brief of summons or brief of arguments in which the lender demands the capitalization of interest that has accrued for at least one year on the monies that were lent, or when the borrower explicitly permits the lender to capitalize interest that has accrued for at least one year on the monies that were lent. Such permission cannot be granted beforehand in the loan agreement.

Usury

Section 494 of the Belgian Penal Code punishes the person or company that commits usury with a prison sentence of between a month and a year and/or with a fine between EUR 136 and EUR 1360.¹⁸ Moreover, the court can decrease the interest rate and the debtor's obligations.

Under Belgian law, one commits usury if one habitually abuses a debtor's weakness, passion, ignorance or needs to force the debtor to pay interest that exceeds the legal interest or that at first glance exceeds the interest rate that is usually applied for this kind of loan, taking into consideration the payment risk.

Since it has to be proven that the suspect made a habit of abusing the debtor's weakness, passion, ignorance, or needs, this criminal sanction is seldom applied.

Negative covenants

Negative pledges are considered to be the personal contractual obligations of the debtor that do not generate any security right in favour of the creditor. Belgian law does allow, as a rule, negative pledges.

If the debtor giving a negative pledge does not respect its obligation, as a result of which certain rights are transferred or granted to a third party, these rights cannot be rendered void provided that the third party acted in good faith and the required formalities (if any) have been complied with. In such case, the lender will normally be entitled to claim damages.

Events of default

Parties are free to determine what (potential) events may trigger certain (repayment) obligations under a senior facilities agreement, provided that such provisions do not violate the Belgian public policy and/or any mandatory legal rules. The general contractual limitations, as set out throughout this chapter apply.

It should be noted that according to the Belgian Civil Code, obligations are void when they are made dependent on one or more conditions of which the occurrence entirely depends on the discretionary action or inaction of the other party.¹⁹

The following two 'standard' events of default require specific care, from a Belgian point of view:

Administration (sursis) Under Belgian administration law of 31 January 2009 ongoing contractual obligations may not be ended or an event of default may not be invoked solely because of the filing or the start of administration proceedings by a Belgian company.

Change of control Most senior facilities agreements provide that a change of control will constitute an event of default that may lead to an increase in liability on the part of a Belgian party to such loan agreement.

The Belgian Company Code provides that any contractual obligation, which provides for an increase in liability in the case of a change of control of a Belgian 'société anonyme (SA)' or 'Naamloze Vennootschap (NV)', must be approved by the shareholders' meeting and registered with the competent Registry of Commerce. Non-compliance with such formalities may result in the unenforceability of such contractual obligation.

¹⁷ Belgian Civil Code, s 1907.

¹⁸ Situation as at July 2005.

¹⁹ *Condition potestative*.

(5) Assignment and transfers

Novation, subrogation or transfer relating to all or part of the rights and obligations under a senior facilities agreement may have the following consequences on the Belgian security interests and the guaranteed obligations of a Belgian company.

Novation

Section 1278 of the Belgian Civil Code provides that privileges (voorrechten) and mortgages (hypotheken) will cease to exist unless otherwise specifically provided. Although there is no conclusive case law on this, the majority view is that security interests such as pledges and guarantees, which are not specifically mentioned in s 1278 of the Belgian Civil Code, will continue to exist if specifically provided for.²⁰

Transfer

Section 1692 of the Belgian Civil Code provides that suretyship (cautionnement), privileges (privilèges) and mortgages (hypothèques) continue to exist unless otherwise provided. Although there is no conclusive case law on this, the majority view is that security interests such as pledges and guarantees, which are not specifically mentioned in s 1692 (transfer) of the Belgian Civil Code, will also continue to exist in the case of a transfer.

Subrogation

The majority view is that all security rights, including pledges and guarantees attached to the secured claim, continue to exist in the case of subrogation unless otherwise provided.²¹

(6) Role of agent and security trustee

The use of a security agent or trustee

Belgian law does not have an established concept of 'trust'. Therefore it is uncertain how a Belgian judge would interpret the precise nature, effect, and enforceability in Belgium of the duties, rights, and powers of a Belgian trustee and performance or exercise thereof. It is likely that a trustee would be considered the agent (mandataire) of the finance parties. There is however no published conclusive case law in this respect. The best way to solve this problem is to insert a 'joint creditor'/parallel debt' clause in the senior facilities agreement, mezzanine loan and/or intercreditor agreement.

Belgian law does however acknowledge foreign trusts, ie, trusts that are governed by foreign law. To avoid any doubt, the parties to a trust agreement where the trustee is established and incorporated in Belgium, should explicitly choose foreign law to govern their contractual relationships. If no choice of law is made, the law of the country where the trustee was incorporated at the time of the trust's establishment will govern the trust and the rights and duties of the trustee. Given the absence of an established concept of 'trust' under Belgian law and the problems that are caused by this,²² this is best avoided.

Section 5 of the Act of 15 December 2004 regarding security interests over financial instruments provides for an important exception to this rule. This section states that security interests over financial instruments which are granted to a representative of the beneficiaries of these security interests, that acts in its own name but for the account of those beneficiaries, shall be considered valid and enforceable against third parties, including the representative, insofar as the identity of the beneficiaries can be established by means of the agreement. Any change to the beneficiaries' identities does not affect the validity, enforceability, and ranking of the security interests that have been granted.

The representative will have the same rights and prerogatives as the beneficiaries for whom he acts.

Parallel debt language

A parallel debt clause assumes a separate debt (ie, the so-called 'parallel debt'), in favour of the agent/trustee for an amount corresponding to the obligations of the debtor(s) to the various lenders under the senior facilities agreement.

20 Such novation wording could be as follows: 'For the purposes of Article 1271 et seq of the Belgian Civil Code, the Parties agree that upon any novation under the Finance Documents, the Security Interests, guarantees, indemnities, and other undertakings created by the Finance Documents shall continue for the benefit of the Finance Parties, their successors, transferees and assignees, as the case may be.'

21 Belgian Civil Code, s 1249.

22 See above.

An independent claim of the agent/trustee is so created that can be secured by means of security interests. Once the agent/trustee receives these monies under the security interests, it will be the terms and conditions of the intercreditor agreement or senior facilities agreement that determines how the monies are to be applied towards the finance parties.

Such a parallel debt clause resolves the uncertainties which exist in relation to the 'trust' concept as the trustee no longer relies on the trust but on its contractual right to claim under the parallel debt.

(7) Interpretation of contracts

The content of an agreement goes beyond its strict wording and is determined by what a party would reasonably interpret as being contained in such agreement. Under Belgian law, contracts have to be interpreted in good faith. A contract is deemed to contain any terms which could be attributed to an agreement of the same nature according to equity, customs and the law. In the event of a dispute, the judge will search for the common intention of the parties, applying the above principles. Nevertheless, when the text of the agreement is clear, it should not need to be interpreted.

When confronted with a gap in an agreement, the judge will infer the common intention of the parties from the pre-contractual documents and the performance (or non-performance) of the agreement. Reasonableness and fairness are important in this process.

E. SECURING THE ACQUISITION FINANCE: RESTRICTIONS ON GIVING SECURITY AND GUARANTEES

Legal restrictions on providing security by Belgian companies are, in acquisition and structured finance transactions, as a rule, mainly driven by the principles of financial assistance and corporate benefit (see below). Consequently, if no financial assistance and corporate benefit issues exist, a Belgian company can, most probably, secure acquisition facilities, refinancing facilities, revolving facilities, working capital facilities, and mezzanine loans.

(1) Corporate power: limitations included in the memorandum and articles of association

The basic principle

The actions or transactions entered into or executed by Belgian companies have to comply with the company's articles of association and in particular with the company's purpose clause as mentioned in these articles of association. Under Belgian law, all activities that are explicitly mentioned in the company's purpose clause and all means that would directly or indirectly be useful to perform such activities (even when they are not explicitly mentioned in the articles of association) are deemed to fall within the scope of the company's purpose. According to Belgian legal scholars the following activities should be interpreted as not being part of the company's purpose:

- activities and means that are explicitly excluded from the company's purpose;
- activities that appear not to be included in the description of the company's purpose;
- means which seem to be, not even indirectly, beneficial to the accomplishment of the company's purpose.

Consequences of a breach

Third parties will be able to rely on agreements that were entered into by the company even if these agreements are not within the scope of the company's purpose, save where the third party was aware of the fact that the agreements did not fall within the scope of the company's purpose.²³ Whether third parties were or should have been aware of the fact that the agreements were not within the scope of the company's purpose will depend on the degree of professionalism of the third party. This means that it will be more difficult for a banker or an investor that makes a large sum available, to prove that he was not aware of the agreement falling outside the scope of the company's purpose. A thorough investigation of the company's articles of association is therefore a necessity to avoid any unpleasant surprises.

(2) Corporate benefit

The basic principle

The granting of a security by a Belgian company must always be to the 'corporate benefit' of such Belgian company. However, as this mainly depends on the factual situation (such as the benefit which the Belgian company will obtain from the transaction as a whole) this point can never be settled beyond doubt.

²³ Either based on the principle of confidence (for CVOA, VOF, and Comm V) or the law (for NV, BVBA, and CVA).

In seeking to appreciate the corporate benefit to a Belgian company which provides security interests, it is necessary to look into (i) primarily the direct benefits which the Belgian company will derive from the transaction, such as direct and indirect borrowings, and (ii) then only as an ancillary issue, the indirect benefits, such as the benefit to the group.

In the absence of any conclusive case law in this respect, the majority of Belgian legal writers consider that a direct corporate benefit for a Belgian company that grants security interests and enters into certain agreements to be of the utmost importance.

However, recent legal articles relating to 'group benefits' and 'LBO financing transactions' indicate that the idea of 'group benefit' (ie, indirect benefit), which is already recognized in other European legal systems, is now gaining recognition in Belgian legal writing. A couple of brave lower courts²⁴ stated years ago that aid that is provided by one group company to another company is not by definition unlawful, if such aid (i) is limited in time, (ii) is in proportion to the real opportunities for the company that provides the aid, (iii) has a reciprocal character, eg, (deferred) compensation for the company that provides the aid, (iv) can be seen to be part of a global group policy and (v) does not harm the interests of both group companies.

However, it should be reiterated that no conclusive (published) case law exists which provides that a mere indirect benefit is sufficient for a Belgian company to grant a guarantee/security interest.

Consequences of breach

The entering of a Belgian company into an agreement without sufficient corporate benefit may incur civil and criminal liabilities for the directors of the relevant Belgian company. It may furthermore lead to the relevant security interests and the related agreements being annulled.

Another implication of an act performed without due consideration (which is similar but not the same as an act without 'corporate benefit') is that Belgian bankruptcy law provides that such acts or transactions may be declared null and void if entered into during the hardening period which is a period of maximum 6 months prior to the court decision declaring the company bankrupt.

Considerations

In order to satisfy the corporate benefit requirements under Belgian law, several issues should be taken into consideration.

First, and irrespective of the corporate benefit issue, it is generally accepted by Belgian finance practitioners that a Belgian company cannot grant security interests for all indebtedness due under a facilities agreement if this would expose the company to the risk of having to pay an amount which exceeds its financial capacities. Therefore, security interests are in most cases limited in time and amount.

Secondly, if the granting of security interests by a Belgian company does not provide for any 'corporate benefit', it is advisable to create a direct corporate benefit, eg, by paying a fee.²⁵

Furthermore, the minutes of the board of directors of a Belgian company approving the security interests and the other related agreements, as the case may be, should reflect this 'corporate benefit' concern and justify extensively the granting of the security interests.

Finally, and also related to the corporate benefit issue, the preferred security structure of an acquisition finance transaction is a pyramid structure whereby the security interests issued by the Belgian company secure the guaranteed obligations of such Belgian company under the guarantee reflected in the senior facilities agreement.

Preferred pyramid structure

In a pyramid structure, the security interests provided by a party secure a guarantee. As the guarantee will normally include guarantee limitation language, the security interests will automatically be limited. This structure is preferred because it is simple and provide for one global limitation. As a consequence, if one security interest is worthless (eg, because the underlying assets are worthless) other security interests will become more important.

If there is no evident direct benefit, it may be advisable to create one, by means of one of the following mechanisms:

²⁴ Vz Kh Brussels 27 April 1978, *RPS* 1978, 236; Kh Luik 13 October 1981, *RPS* 1982, 45 and Brussels 9 October 1984, *RPS* 1986, 50.

²⁵ See below.

- a fee arrangement to be issued by the company whose obligations are being guaranteed by such Belgian guarantor. This fee arrangement can be constructed in several ways, eg a percentage of the limited guaranteed obligations of the Belgian guarantor under the senior syndicated facilities agreement on an annual basis; or a one-time fee payment of a percentage of the limited guaranteed obligations of the Belgian guarantor under the senior syndicated facilities agreement;
- an intercompany loan from the borrower to the Belgian guarantor; or
- set off of mutual debts between the borrower and the Belgian guarantor.

Because of the lack of conclusive case law, there is no generally accepted practice to deal with the application of the corporate benefit issue under Belgian law. In order to safeguard the position of the lenders, a firm security structure must always be one of the first issues to be addressed at the outset of an acquisition/structured finance transaction.

(3) Financial assistance rules

The basic principle

A Belgian company may not advance funds, nor make loans, nor provide security, with the view to the acquisition of its shares by a third party.²⁶

Compliance with this rule has to safeguard the company's capital and therefore the interests of the company's creditors.

The separate elements of financial assistance

The advancing of money or granting of loans Providing financial means to enable a third party to purchase existing shares of the company is forbidden. Under Belgian law, there is discussion whether providing financial means to allow third parties to purchase new shares or new categories of shares which are issued within the framework of an increase of capital, is also forbidden. The majority of Belgian legal scholars are of the opinion that the financial assistance rule also applies to new shares or categories of shares. Unfortunately, conclusive case law on this matter is not yet available.

The question as to whether the partial acquisition of shareholders' rights falls within the scope of the financial assistance rule is also a point of discussion. The majority of Belgian legal scholars are of the opinion that the financial assistance rule does not apply to such an acquisition. Given the lack of conclusive case law on this matter, it is wise to act with caution in this respect.

It is however clear that the following actions do not fall within the scope of the financial assistance rule:²⁷ (i) payment of dividends, (ii) decreasing the capital, (iii) acquisition of the company's own shares, (iv) paying off the capital, (v) the payment of the company's reserves, even if this is financed by third parties and company assets are given as a guarantee, (vi) paying compensation for the sale of assets or services that were provided as long as the compensation is fair considering the value of the assets or the services that were provided, (vii) payment of a final dividend following the winding up of the company. Also allowed is a transaction in which a shareholder who is also creditor of the target company, transfers its debts to the party that acquires the target company's assets and whereby the acquisition price is decreased. Finally, granting a pledge over the target company's shares by the party that acquires these shares is also allowed.

Granting security interests The security as referred to in the above-mentioned financial assistance sections of the Belgian Company Code refers to all securities, including the classic securities in rem, ie, pledges, floating charges as well as floating charge mandates, mortgages and mortgage mandates, personal guarantees or security, eg, suretyship. According to some legal scholars, the prohibition on providing security refers to any procedure the purpose of which is to make the assets of the target company available or usable to provide third parties with the opportunity of acquiring the target company's shares.

Therefore, certain clauses that are inserted in the facilities agreement in order to safeguard the target company's assets, eg, negative pledges, are allowed. In principle, the new securities like the letters of intent, letters of comfort, cash deficiency clauses are also allowed save when they are formulated in such a way that they can potentially harm the assets of the target company.²⁸

²⁶ Belgian Company Code Arts, 329, 430, 629, and 657.

²⁷ All the transactions that are mentioned here will also be governed by other rules set out in the Belgian Company Code, applicable Tax and Accounting Laws. All relevant rules that are set out by these laws will have to be complied with.

²⁸ K Troch, 'Ondernemingsfinanciering bij de overname van vennootschappen. Een praktische commentaar op artikel 629 Wetboek van Vennootschappen' in *Vennootschap- en financieel recht*, 4, Larcier, Gent, 26.

'With the view to' Under Belgian law, there is some discussion regarding the way one has to evaluate the intention of the target company within the framework of the financial assistance rule.

Some courts and legal scholars²⁹ find that it is only forbidden for the target company to provide financial means or security to third parties when such means or security is provided with the main intention of allowing these third parties to acquire its shares. If the chronology of the actions taken shows that the financial means and security were not provided with such intent, these actions are allowed. Therefore, there would be no breach of the financial assistance rule if the third party first buys the target company's shares and later receives financial means or security from the target company which the third party could use to pay its debts to the banks. On the same level, other legal scholars find that the target company's intention has to exist prior to the granting of financial means or security.³⁰ According to these legal scholars, if the target company had no such intention at the time of the granting of the means or security but, later on, it is proven that the means or security were used for third parties to acquire the target company's shares, the financial assistance rule is not breached. But, this viewpoint is rather academic since the courts will look for objective elements and will mostly disregard hard to prove subjective elements.

The above-mentioned viewpoint is strongly contested by legal scholars who feel that the chronology of the facts is of minor importance. It does not matter whether the intention of the target company to provide financial means or security to third parties in order to allow them to acquire its shares dates from prior to or after the acquisition of the shares. It is also not important that the acquisition was the main intent or is only of subsidiary importance. In the light of this the target company's intention can be proved, among other ways, by the timing of the various actions, the similarities between the amounts and the lack of a sufficient economic justification for providing financial means or securities by the target company.³¹ Only when there is absolutely no causal link present between the granting of the financial means or security and the acquisition of the shares, then the financial rules are not breached.³²

Acquisition of shares or other securities that provide the owner or the keeper of these securities with a right to receive dividends³³ This means that transactions whereby the target company's assets and not its shares are acquired, are allowed. Also allowed are transactions whereby the third parties do not obtain shares or securities that grant the owner or keeper rights to receive dividends, but other securities like, among others, warrants, options, convertible bonds, or bonds with warrants. However, converting the bonds directly after the acquisition could be requalified as the acquisition of shares that is financed by the target company and therefore in breach of the financial assistance rule.³⁴ The number of shares acquired is of no significance.

Exemptions to the financial assistance prohibition

There are two exceptions to the scope of the financial assistance rules.

- The financial assistance rules do not apply to transactions performed by banks, provided that these transactions fall within the framework of the normal course of business and that the transactions' conditions and securities can be considered as normal for that kind of transaction;³⁵ and
- they also do not apply to (i) advances, loans and security provided to the company's employees in order to provide them with an opportunity of acquiring the shares of the company-employer or to (ii) advances, loans, and security provided to linked companies of which the majority of voting rights are owned by employees of the company that provides the advance, loan, or security, in order to enable the employees to acquire the shares of the company that provides the advance, loan, or security.

29 J-P Blumberg and R Nieuwdorp, 'Juridische aspecten van de (Leveraged) Management Buy Out', *TBH* 1989, 124.

30 R W TH Norbruis, 'Juridische klippen bij de financiering van "leveraged" ondernemingen' *De NV* 1990, 97.

31 R Tas, *Winstuitkering, kapitaalvermindering en-verlies in NV en BVBA*, in *Rechtspersonen- en vennootschapsrecht Jan Ronse instituut-K U Leuven*, Kalmthout, Biblo, 2003, 133.

32 K Troch, 'Ondernemingsfinanciering bij de overname van vennootschappen. Een praktische commentaar op artikel 629 Wetboek van Vennootschappen' in *Vennootschap- en financieel recht*, 4, Larcier, Gent, 2004, 29.

33 *Winstbewijzen / parts bénéficiaires*.

34 M Verplancke, 'Artikel 629 W Venn', in X, *Vennootschappen en verenigingen. Artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Antwerpen, Kluwer, losbl, 2000, nr 11.

35 Belgian company code, ss 629, §2, 1° and 430, §2, 1°.

Whitewash procedure

The law of 1 January 2009 introduced under Belgian law a whitewash procedure. The formalities for such a procedure are that the directors of the target must prepare an elaborate report which must be approved by the shareholders' meeting with a majority of 75% of the votes before the Belgian target can provide financial assistance.

The conditions for such a procedure are:

1. the financial assistance must take place at reasonable market conditions;
2. the report of the directors of the Belgian target must be registered with the commercial registry and must be published in the Belgian State Gazette;
3. the directors of the Belgian target must assess (and are responsible for such an assessment) that the acquiring entity can reimburse the loan for which financial assistance is provided;
4. the maximum amount of the financial assistance is limited and is roughly the amount which can be distributed by the Belgian target to its shareholders; and
5. an amount must be blocked in the accounts of the Belgian target which is the equivalent of the amount of the financial assistance.

This procedure is rather cumbersome and most probably it will only be used in a very limited number of circumstances.

Strict interpretation

The majority of Belgian legal writers accept that the rules of financial assistance must be interpreted strictly,³⁶ and that any assistance which does not fall within the strict wording of the Belgian Company Code will not be caught by the prohibitions, ie, any funds, loans or security made available for an indirect acquisition of the shares of a Belgian company do not fall under the Belgian financial assistance prohibition. There is, however, no conclusive case law in this respect.

Consequences of breach

A transaction that does not comply with such rules may be declared null and void, upon the request of any interested party. Such nullity will not necessarily be limited to the transaction itself (ie, the loan or the security) but may also affect connected transactions which would not have occurred without the relevant act or which led to the existence of the unlawful legal scheme that was set up, insofar as these transactions were willingly performed by all the parties involved. Therefore, the whole transaction could be declared void.³⁷

Non-compliance with the financial assistance rules may also trigger civil liability of the directors and auditors of all companies that provided any form of financial support or security which was in breach of the financial assistance rules and all parties that advised the transaction be structured in such a way that the financial assistance rules were breached.

Finally, the breach of the financial assistance rules may lead to the criminal liability of any person that breached those rules.³⁸ The guilty party can be punished with a fine between EUR 550 and EUR 55,000, and imprisonment for a period between one month and one year.

The case in hand

First hypothesis The investors, the new acquisition holding company, the group holding company, the senior lenders and the mezzanine lenders are incorporated and located in Belgium, while the subsidiaries are incorporated and located elsewhere.

The three parties that can provide security are (i) the local subsidiaries, (ii) the acquisition holding company, and (iii) the group holding company.

- The local subsidiaries can provide security if that is permissible under their local law. Belgian law is, as a rule, not involved.
- The acquisition holding company can provide the syndicate of senior lenders and the syndicate of mezzanine lenders with security interests over its assets, since these parties do not acquire any of the

³⁶ K Troch 'Ondernemingsfinanciering bij de overname van vennootschappen. Een praktische commentaar op artikel 629 Wetboek van Vennootschappen', in *Vennootschap- en financieel recht*, 4, Larcier, Gent, 2004, 35.

³⁷ M Verplancke, 'Artikel 629 W Venn', in X, *Vennootschappen en verenigingen. Artikelsgewijze commentaar met overzicht van rechtspraak en rechtsleer*, Antwerpen, Kluwer, losbl, 2000, no 24.

³⁸ Belgian Company Code, ss 347, 4° and 648, 7°.

acquisition holding company's shares. The latter is not allowed however to provide security over its assets to the investors (see above).

- The group holding company will be prohibited from providing security to the acquisition holding company, the investors, the syndicate of senior lenders, and/or the syndicate of mezzanine lenders as its shares are acquired.

Second hypothesis One or more of the subsidiaries are incorporated in Belgium, while the other parties are incorporated and located elsewhere.

In this hypothesis, the subsidiaries are most likely allowed to secure the senior and mezzanine secured loan in view of the Belgian financial assistance rules, because it is not their shares that are acquired but the shares of their parent company. As mentioned above, no conclusive case law on this issue is available as yet.

Belgian law will not govern the legal options of the other parties and the validity and enforceability of the transaction that was envisaged, because none of these parties are incorporated in Belgium.

Possible solutions³⁹

The doctrine and case law offer a limited number of sometimes criticized solutions to the financial assistance issue.

- The intervention of a linked company: First there is the course of action in which a company is inserted between the entity providing security and the acquired company.
- Dividing the target company's assets: Dividing the target company's assets over two or more companies can also offer a solution. For instance, next to the target company a new company can be incorporated to which part of the target company's assets, eg, the real estate, is transferred. The buyer will then first obtain the shares of the real estate company. The latter will enter into a loan agreement which is secured by a mortgage over the real estate. The loan is used to acquire the shares of the second company, ie, the target company, which holds the other assets.
- The founding of a holding company which will merge with the target company: In line with legal practitioners and financiers in neighbouring countries, Belgian legal practitioners try to make an acquisition possible while complying with the financial assistance rules by founding a new holding company, which is financed by the equity investors and a bank loan. This new holding company will then buy the shares of the target company and will later merge with the target company. The assets of the merged companies will then act as collateral for the repayment of the bank loan. This method also provides the company that is the result of the merger between the new holding company and the target company with the opportunity of deducting the interest payable under the bank loan. Notwithstanding the fact that it is still not entirely clear if this method breaches the financial assistance rules, the majority of courts and legal scholars consider this method of acquisition finance as legally valid and acceptable, as long as there are sufficient objective motives that can justify this transaction.⁴⁰
- Asset acquisition: The buyers will also found a new company, which will obtain a loan, eg, syndicated facilities. The loan will not be used to buy the target company's shares but to buy certain or all assets of the target company. It is possible to link the loan to an obligation for the new company to provide the banks with security over the acquired assets. The assets will be used to repay the bank loan. After that, the target company will be liquidated and the shareholders will be paid with the proceeds received by the target company for the assets sold to the new company. If necessary, the new company can take on the name of the liquidated target company and continue doing business under that name.

³⁹ The solutions mentioned have been dealt with briefly. For a more detailed description of each solution, including advantages, disadvantages and discussion points raised by legal scholars, refer to: K Troch, 'Ondernemingsfinanciering bij de overname van vennootschappen. Een praktische commentaar op artikel 629 Wetboek van Vennootschappen', in *Vennootschap- en financieel recht*, 4, Larcier, Gent, 87–97.

⁴⁰ This method of acquisition finance will be illegal if it is clear that it is only used to circumvent the financial assistance rules.

In order to pass the financial assistance rule test it is at least required that the above-mentioned solutions are in the corporate interest of the intervening or used companies, that all legal requirements are met by these companies and that there is no form of simulation,⁴¹ name lending,⁴² fraud, or abuse of law.

These methods are not risk-free. The courts can always find that the method that was used to steer clear of any possible breach of the financial assistance rule was in fact abuse of law.

(4) The limitations of the Belgian Company Code

All limitations of the Belgian Company Code have to be complied with.

Section 617 of the Belgian Company Code for instance prohibits the company⁴³ (NV/SA) from granting a dividend if, at the closure of the last fiscal year, the net assets as mentioned in the annual accounts, have dropped or will drop because of the granting of a dividend below the amount of the paid up or soon to be paid up capital, increased by the reserves that are legally required or set out in the articles of association.

Non-compliance with this prohibition may result in the criminal and civil liability of the directors of the company that breaches the rule and of any other person who willingly made this breach possible.

(5) Abuse of law ('fraude à la loi')

The construction of a financing transaction in a certain way for the mere reason of avoiding Belgian financial assistance rules is not allowed under Belgian law. Therefore, the board of directors which approves the structured finance transaction has to justify extensively why a certain structure is set up (eg, tax reports, realization of certain synergies between group companies, etc).

F. SECURING THE ACQUISITION FINANCE: POSSIBLE SECURITY AND FORMALITIES

(1) Security—the general principles

Securities—overview

The main security interests available under Belgian law can be divided into three categories:

(1) Pledge over tangible assets: its main feature is the dispossession requirement of the pledged asset, ie, the pledged asset must be delivered into the possession of the pledgee or an agreed third party. The following pledges are specific applications of a pledge over tangible assets:

- pledge over receivables (eg, trade receivables, intercompany receivables, etc)
- pledge over contracts (eg, receivables resulting out of insurance contracts, lease contracts, acquisition documentation, etc)
- pledge over bank accounts
- pledge over intellectual property (IP) rights (trademarks, patents, copyright)
- pledge over shares (registered shares, bearer shares, dematerialized shares) and other financial instruments
- pledge over tangible assets

(2) Pledge over business: this type of pledge can be considered 'floating' because, whilst the beneficiary has a preferential right on the assets covered by the pledge, the owner of the business is not required to give up his possession of the assets and is entitled to run and operate his business as usual.

41 Under Belgian law, simulation is present when the parties want to give the impression that they have performed a certain legal act while they have secretly done something completely different, in line with their real wishes and goals. Simulation is in principle allowed as long as it is not used to contravene legal requirements or to infringe on the rights of third parties. These third parties can choose whether they acknowledge the simulated action or the real action.

42 Under Belgian law, name lending is present when the company gives a mandate to a mandate holder which will act in the name of the company but for its own account, while the status of mandate holder is kept secret from third parties. Name lending is allowed, save when it is used to contravene legal requirements or when it harms the interests of third parties.

43 Section 617 of the Belgian Company Code applies to the NV/SA. The same rule applies to the CVBA (BCC, s 430, §2) and for the BVBA (BCC, s 320).

(3) Mortgage: a security over land, buildings or other real rights in Belgium which are owned, or held on a long lease, 'superficie', usufruct, etc is vested by means of a mortgage. A specific regime exists for mortgages over vessels.⁴⁴ A mortgage over an aircraft is not possible under Belgian law.

Formalities and documents

All security interests under Belgian law (with the exception of mortgages) can be created by means of a private agreement. A mortgage must be created by means of a notarial deed.

Security interests governed by foreign law

Final judgments with respect to security interests governed by foreign law, such as debentures/charges/floating charges, assignments, pledges, etc, are in principle recognized and enforceable in Belgian courts, if the following conditions are complied with.

If no international treaty applies, a final judgment handed down by a court of competent jurisdiction of such foreign country in respect of the foreign security interest will be recognized and enforced in Belgium after a review of the merits of the case by a Court of First Instance in Belgium and if such Belgian Court of First Instance is satisfied that the conditions set out in Article 570 of the Belgian Judicial Code, are fulfilled (ie, the usual conditions relating to public policy constraints, the fact that the defendant's rights of defence have been observed, etc).

Where the Council Regulation (EC) applies, a judgment handed down by a court of competent jurisdiction of such EC foreign country in respect of the foreign security interest must be recognized and may be enforced in Belgium without a review of the merits of the case, in accordance with the conditions set out in the Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Enforcement is subject to a prior judgment in Belgium and to the Belgian rules of civil procedure.

Ability to take security over future assets

Future assets can only be pledged under a pledge over receivables and a pledge over bank accounts. Future assets are de facto comprised in the pledge over business.

A pledge over future shares, IP rights, tangible assets (other than those mentioned in the above paragraph) can as a rule only be covered by means of an undertaking of the Belgian company to pledge such assets.

(2) Mortgage

General principles

Under Belgian law, it is possible to take a mortgage over any land, buildings or other rights related to real estate in Belgium which are owned, or held on a long lease, 'superficie', usufruct, etc.

A mortgage entitles the mortgagee to a preference right over the proceeds of the sale on foreclosure.

Formalities

The mortgage must be constituted by way of a formal deed and passed before a Belgian notary.

The mortgage deed must specify the secured amount and must contain an exact indication and description of the property. The mortgage will guarantee up to the secured amount plus three years' interest and certain expenses.

There is no central land register or mortgage register, but the mortgage must be registered in the appropriate local mortgage register where the property is situated in order for it to be enforceable against third parties. The registration is valid for an initial period of a maximum of 30 years and is renewable.

Mortgage mandate

Mortgage mandates (ie, irrevocable powers of attorney to execute a mortgage deed) are occasionally used as an alternative to a mortgage, in order to avoid the registration costs which mortgages incur.

However, they do not constitute a security enforceable against third parties and their practical value to the beneficiary is limited. Mortgage mandates cannot be registered in the mortgage register, and if the company which has granted the mortgage mandate breaches any negative pledge obligations and grants a mortgage to another creditor acting in good faith, or sells the property, before a mortgage has been executed and registered pursuant to the mandate, then the mortgage of the other creditor or the new unencumbered property rights of the owner take priority.

⁴⁴ Given the scope of this chapter, mortgages over vessels are not dealt with further.

Use in acquisition finance transactions

A registered mortgage is in most acquisition/structured finance transactions used in combination with a mortgage mandate, ie, the registered mortgage is entered into for a rather small secured amount (the so-called 'mini-mortgage') combined with a mortgage mandate for the amount of the remainder of the debt to be secured. Such mortgage mandate can be converted into a registered mortgage upon the discretionary demand of the lenders, as long as the party that has given the mandate is not in involuntary liquidation.

(3) Pledges over tangible assets

Civil and commercial pledge

Belgian law distinguishes between civil and commercial pledges. Whether a pledge is characterized as civil or commercial will depend upon whether the secured obligations are commercial or not. In practice, most acquisition finance transactions are by their nature commercial and therefore the pledge will be considered to be commercial. This chapter deals only with commercial pledges.⁴⁵

It is not necessary that the pledge agreement be governed by Belgian law. The parties are in principle free to choose the governing law. In practice, however, if the pledged assets are located in Belgium and/or it is likely that enforcement may be sought before the Belgian courts, then it is usually advisable to have the pledge agreement drawn up in accordance with and expressly governed by Belgian law.

The requirement of dispossession

The key element of a pledge is that the pledged assets must be delivered into the possession of the pledgee or an agreed third party. As long as the pledgor does not part with the asset which is to be pledged, there is simply no pledge. In addition, a validly created pledge will cease to exist as soon as the dispossession is discontinued. Possession is a matter of factual circumstances depending on the type of asset pledged.

Only in a few limited cases and under strict conditions has case law accepted that substitution can take place without affecting the original security. These conditions are (i) the immediate, simultaneous replacement of the original asset (ii) by new assets of the same nature and the same value as those replaced.

Formalities

A valid and effective pledge can be created by the sole delivery of the asset to the pledgee or the third party pledgeholder. There are no further documentary requirements or other formalities other than those required to effect a legal and valid transfer of the asset concerned, to make the pledge effective vis-à-vis third parties.

It is not necessary to specify the amount secured in the pledge agreement and a pledge for 'all sums due' will be valid, provided that the secured obligations can be determined or are determinable.

Use in acquisition/structured finance transactions

A pledge over tangible assets is only used in acquisition/structured finance transactions if the dispossession requirement is feasible for the parties concerned. Mechanisms such as a sale lease-back can be used in order to circumvent the dispossession requirement.

However, below are pledges over specific tangible assets in which the dispossession requirement poses in practice no issue or is perfected in a different manner than the actual dispossession of the pledged asset to the pledgee or a third party.

(4) Pledges over shares and other financial instruments

General principles

The articles of association should be examined at the outset to establish the form of the shares and whether there are any provisions which may impact on or restrict taking a pledge over shares, or which may restrict the transfer of the shares in the event of enforcement.

Any voting rights attached to the pledged shares do not automatically pass to the pledgee by virtue of the pledge. This has to be specifically provided for in the pledge agreement.

⁴⁵ The key characteristics of a civil pledge are the following: It must be created by a written notarial or a registered private agreement. Both agreements will be registered in order to have a fixed date which is important in case there are several pledges on the same property. The pledge agreement must be drawn up, for registration purposes, in one of the Belgium's official languages.

Registered shares

The dispossession of the registered shares and the enforceability of the pledge against third parties is perfected by entering a statement of the pledge in the share register, or by notification of the pledge to the issuer of the pledged shares (ie, the company concerned), or acceptance of the pledge by the debtor.⁴⁶

Share certificates are mandatory for registered shares, but often not printed. It is preferable to have them delivered to the pledgee with a statement that the shares are pledged.

Bearer shares

The dispossession of the bearer shares and the enforceability of the pledge against third parties is perfected by the delivery of the bearer certificates either to the pledgee or an agreed third party.

Dematerialized shares

A special procedure is provided for a pledge over dematerialized shares.

The dispossession of the dematerialized shares and the enforceability of the pledge against third parties is perfected by the registration of the shares on a special pledge account of an associated member of the CIK. The pledged shares are identified according to their nature without a statement of their number.

The right to use financial instruments

The pledgor and pledgee can agree to give the pledgee the right to use the pledged financial instruments during the course of the agreement. If the agreement is terminated, the pledgee has to provide the pledgor with financial instruments that are similar to the financial instruments that were initially pledged, both with regard to numbers and characteristics.⁴⁷

(5) Pledges over invoices

A special procedure is provided under the Belgian Act of 25 October 1919 for pledges over invoices. Like a pledge over business, a pledge over invoices may only be vested in favour of duly licensed banks.

The applicable formalities consist of (i) endorsement of the invoices to be pledged, by way of security (ie, realization of the dispossession requirement), and (ii) notice to the pledged debtors by registered mail that they can validly pay to the pledgee. The latter requirement only serves the purpose of informing the debtors and does not affect the validity of the pledge. Failing the latter requirement, any debtor in good faith would be validly discharged by payment to the pledgor.

Please note that this procedure is not mandatory. It is possible to pledge invoices as receivables, taking into account the fact that the procedure for pledging receivables is more common and flexible.

(6) Pledges over receivables

Until the new Belgian Conflict of Law Code came into practice, the rules on pledges over receivables where one or more of the parties were foreign, were fairly simple. The dispossession of the receivable was realized by the execution of the pledge agreement. The pledge agreement became enforceable against third parties because of the execution of this agreement. Finally, the pledge agreement became enforceable against the debtor of the pledged receivable by notification of the pledge to such debtor, or acceptance of the pledge by the debtor.

This situation now only applies when the pledgor is incorporated in Belgium when the pledge was granted and if the pledge is governed by Belgian law.

In all other cases, the validity of the pledge agreement and the contractual relationship between the pledgor and pledgee will be governed by the law chosen by the parties within the limits of Article 3 of the Convention on the law applicable to contractual obligations signed in Rome on 19 June 1980,⁴⁸ or, if no law was chosen, by the law that is determined by this Convention to govern the agreement.

⁴⁶ Belgian Civil Code, s 1690.

⁴⁷ Section 11 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *BS* 1 February 2005.

⁴⁸ Convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980, *Official Journal* L 266, 1–19.

How the pledge over receivables is made enforceable against third parties, including the debtor of the pledged receivable will be determined by the law of the country where the pledgor was incorporated at the time when the pledge was granted.⁴⁹ The same law will determine whether a transfer of receivables is enforceable against third parties.

Along with specific receivables, it is also possible to grant a pledge over a portfolio of receivables, including current and future receivables, which can also be pledged as a pledge over receivables.

(7) Pledges over bank accounts

A pledge over bank accounts is considered as a pledge over cash, and will be governed by the general pledge rules and by the Act of 15 December 2004 regarding security interests over financial instruments.⁵⁰

The same rules as those that apply to pledges over receivables will apply to pledges over bank accounts.

(8) Pledges over intellectual property rights

Pledge over a Benelux/EC/international trademark

The dispossession of the trademark and the enforceability of the pledge against third parties is perfected by inscription of an extract of the pledge agreement in the trademark register of the depository concerned, assuming that the initial depository has been vested according to the applicable procedure.

Pledge over a Belgian patent

The dispossession of the patent and the enforceability of the pledge against third parties is perfected by written notification to the Service for Intellectual Property. The notification is inscribed in the specific register.

Pledge over a copyright

The dispossession of the copyright and the enforceability of the pledge against third parties is perfected by the notification to a third party to whom claims can be addressed (eg, Sabam).

(9) Pledges over business—‘floating’ charge

A security technique, which is similar but not identical to a ‘floating charge’, is the pledge over business, governed by the Belgian Act of 25 October 1919.

Principle

A pledge over business confers upon the beneficiary a preferential right over the assets constituting the business of the pledgor, subject to certain exclusions and other limitations with regard to both the beneficiaries and the assets covered.

Beneficiaries

Only banks or credit institutions carrying a specific administrative authorisation to that effect are qualified to take a pledge over business.

Assets that can be pledged

In principle, all items comprising the business are covered by the pledge. These items include the clientele, the trade names, the commercial organization, any trademarks, any lease rights, furniture, and equipment.

Inventories are only covered if expressly agreed between the parties and up to an amount not exceeding 50% of their value. It is also accepted that receivables and cash may be included in the pledge provided that the parties expressly provide for this in their agreement. Consequently, receivables relating to material contracts (such as a keyman policy agreement, warranty agreement, intercompany loan agreement, etc) can be explicitly mentioned in, and covered under, the pledge over business.

Conversely, parties may expressly exclude certain items which would otherwise form part of the business and thus of the pledge, provided they are not an essential element of the business.

⁴⁹ Belgian Conflict Law Code, s 87 §3.

⁵⁰ Law of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *BS* 1 February 2005.

This type of pledge can be considered 'floating' because, whilst the beneficiary has a preferential right over the assets covered by the pledge, the owner of the business is not required to give up his possession of the assets and is entitled to run and operate his business as usual, provided that he does not do anything affecting the consistency and value of the business.

Formalities⁵¹

The pledge over business must specify the secured amount.

There is no central register for pledges over businesses, but the pledge over business must be recorded in the mortgage register for each judicial district in which the pledgor has a place of business, in order to be enforceable against third parties in respect of assets in that district. The registration is valid for an initial period of ten years and is renewable.

Pledge over a business mandate

It should be noted that a pledge over a business mandate is occasionally used as an alternative to a pledge over business, generally to avoid the costs which a pledge over business involves. Such mandate is not enforceable against third parties and does not provide the holder of the mandate with any priority right over the business as long as the mandate is not converted into a pledge and such pledge is not registered with the mortgage register.

The disadvantages of a pledge over business mandate are similar to the disadvantages of a mortgage mandate as set forth above.

Use in acquisition finance transactions

A registered pledge over business is used in most acquisition/structured finance transactions in combination with a pledge over business mandate, ie, the registered pledge over business is entered into for a rather small secured amount (the so-called 'mini-pledge over business') combined with a pledge over business mandate for the amount of the remainder of the debt to be secured. Such a pledge over business mandate can be converted into a registered pledge over business upon the discretionary demand of the lenders. The pledgee will obtain his priority right over the business as soon as the mandate is converted into a registered pledge.

(10) Guarantees

Guarantee⁵²

A guarantee is, most of the time, an autonomous guarantee. Therefore it does not impose a direct independent contractual relationship between the creditor and the party that provides the guarantee. A guarantee is not specifically regulated under Belgian law and consequently the general rules of Belgian contract law will apply which allow full contractual freedom.

Surety (cautionnement)

Next to the guarantee which is expressly governed in Belgian Civil Code there exists the surety that is governed by the Articles 2021 to 2039 of the Belgian Civil Code which provide certain restrictions.

A surety cannot be given for a larger amount than the amount that has to be paid by the debtor of the main agreement, ie, the main debtor. But when the surety is not limited to a certain amount, the surety will be assumed to be issued for all costs additional to the main debt.

Under the Belgian Civil Code, the party that provides the guarantee has the right to refuse payment to the creditor as long as the latter did not use all legal means available to receive payment from the main debtor. The party that provides the surety can waive this right, which is a standard waiver.

If different parties have provided a surety for the same main debtor, each of these parties is liable for the entire debt. Each of these parties can demand that the creditor limits its recourse to such party's respective share of the debt. The party that provides a surety can also waive this right, which is also a standard waiver.

51 For registration purposes, the pledge over business agreement will normally be drawn up in French or Dutch. In the event that a foreign language is used, the document would have to be, for registration purposes, formally translated into one of Belgium's official languages by an official translator.

52 *Garantie.*

The party that provided the surety and that has paid the main debt is subrogated in all the rights the creditor had as regards the main debtor. It can also claim compensation for all expenses incurred and damages suffered. This right can be, and is usually, suspended until full discharge of the bank debt.

Corporate benefit rules should be taken into account on the issue of an autonomous guarantee and surety.

(11) Jointly and severally liable debtors

When there are several debtors, in principle, several liability between the debtors is not presumed but should explicitly be provided for in the contract. Nevertheless, when the joint debtors are merchants in the sense of the Commercial Code (eg, commercial companies) they are presumed to be jointly and severally liable.

The creditor facing jointly and severally liable debtors is entitled to claim payment of the entire debt from one debtor of its choice. The payment by one debtor will release all other debtors vis-à-vis the creditor. The debtor from whom payment is claimed can put forward any objections (exceptions) regarding the joint debt as well as personal objections vis-à-vis the creditor.

Again, the corporate benefit issue is relevant in this respect.

(12) Specific contractual protection: limitation of recourse

Under Belgian law, it is permitted to limit the amount of recourse against the defaulting party.

However, the Belgian courts may restrict the enforceability of provisions limiting, releasing, exculpating, or exempting a party from, or requiring indemnification of a party for, liability accruing from its own action or inaction, to the extent the action or inaction involves wilful negligence or misconduct, fraud or unlawful conduct. The enforceability of such provisions may also be restricted in cases where they have the effect of discharging a party from its obligations and removing, to a material extent, the obligations assumed by such party.

(13) Set off

Three types

There are three types of set off under Belgian law, ie, set off can take place by virtue of the law,⁵³ by agreement,⁵⁴ and by judicial order.⁵⁵

In any event, set off cannot take place when that would be harmful to third parties' rights (eg, in case of seizure of the debt by a third party or an insolvency proceeding). There are however two exceptions to this rule: the first exception concerns closely interrelated debts, eg, the claim of a contractor to receive payment for the work he performed and the claim of the client of this contractor that suffered damage due to the mistakes of this contractor. The second exception concerns netting agreements, or set off by agreement, which is discussed below.

Set off by virtue of the law

Under Belgian Civil Law, set off will automatically occur as soon as all of the following conditions are fulfilled:

- there are mutual pecuniary debts between the same legal persons;
- the debts exist when the set off should take place (future debts are in principle not eligible for set off);
- the debts are due; and
- the set off does not harm the rights of third parties, ie, there is no coming together of creditors (*concursum creditorum*) because of a seizure of the debt by a third party or an insolvency proceeding,⁵⁶ save when the two debts are closely interrelated.

⁵³ *Contractuele schuldvergelijking/compensation légale.*

⁵⁴ *Conventionele schuldvergelijking/compensation conventionelle.*

⁵⁵ *Gerechtelijke schuldvergelijking/compensation judiciaire.*

⁵⁶ This restriction limits the use of clauses that provide for an acceleration of debts, since the events that trigger such acceleration are in most cases events that also cause the coming together of the creditors (*concursum creditorum*), which makes the set off impossible, save when the parties have entered into a netting agreement prior to the coming together of the creditors and the acceleration of debts clause is linked to the netting agreement.

Set off by judicial order

Set off by judicial order is often used to set off a claimable debt against a debt that exists but is not yet claimable.

Set off by agreement

Section 14 of the Act of 15 December 2004 regarding security interests over financial instruments⁵⁷ caused a real revolution under Belgian law. Set off after insolvency was previously only allowed for closely interrelated debts. The aforementioned new section however sets out that a netting agreement that provides for set off after insolvency is valid and enforceable, notwithstanding any insolvency proceedings. This creates considerable opportunities for any lender to create an additional form of security.

However, this lender has to make sure that it is clear that a netting agreement in fact exists. If there is no such agreement, the regular prohibition to set off of mutual debts after insolvency, continues to apply.

Set off and security

Under Belgian law, as a rule, set off by law or by judicial order is enforceable against any secured creditor, save for (i) the pledgee of a pledge over receivables that was duly notified to the receivable's debtor prior to the moment of set off and (ii) the transferee of such receivable, which has notified the transfer prior to the moment of set off.

Set off by a valid and enforceable netting agreement is enforceable against any secured creditor and will take priority over any security.

(14) Transfer of financial instruments as security

While the validity of transfer of property as a security interest in general is still hotly debated under Belgian law, the Act of 15 December 2004 regarding security interests over financial instruments has made such a transfer enforceable insofar as it concerns the property rights over financial instruments.⁵⁸

(15) Repo-agreement re financial instruments

As is the case with the transfer of property as security, the validity of a repo-agreement that was entered into to provide a party with a security interest was formerly very doubtful under Belgian law.

The Act of 15 December 2004 regarding security interests over financial instruments has removed this doubt, albeit unfortunately, only for repo-agreements that concern financial instruments.⁵⁹

(16) Enforcement of Belgian security

Enforcement of a mortgage

A Belgian mortgage has to be enforced in accordance with the rules regarding the seizure of immovable assets, ie, ss 1560–1626 of the Belgian Judicial Code.

The creditor instructs a bailiff to serve an order to pay to the debtor. Together with this order, a copy of the mortgage document or court decision which is invoked by the creditor to demand payment from the debtor will have to be served on the debtor.

A copy of this order to pay is registered with the mortgage register.

Within six months after the order to pay, a second document, a document of seizure, is served on the debtor, which is also registered with the mortgage register.

Within a month of the service of the document of seizure, the creditor has to petition the court to appoint a notary public, who has the task of selling the immovable asset. The sale will normally take place by means of an auction. If it is in the interest of all parties, the court can also grant the notary public permission to sell the property on the market.

⁵⁷ Section 8 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *BS* 1 February 2005.

⁵⁸ Section 12 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *BS* 1 February 2005.

⁵⁹ Section 13 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *BS* 1 February 2005.

The conditions of sale are served on the debtor who has the opportunity of commenting on these conditions. The conditions of sale include a date upon which the auction is arranged.

The holder of a mortgage has priority rights over the sale proceeds, less the costs of the notary, the bailiff and the auction.

Enforcement of a pledge over IP rights, a pledge over tangible assets or a pledge over business

If the pledgee wants to enforce a pledge given under a pledge over IP rights, a pledge over tangible assets or a pledge over business, the pledgee must request judicial authorization just prior to the enforcement of the pledge in accordance with the Act of 5 May 1872 on commercial pledges.

Enforcement of a pledge over receivables or a pledge over contracts

If the pledgee wants to enforce a pledge given under a pledge over receivables or a pledge over contracts, the pledgee may have to request judicial authorization just prior to the enforcement of the pledge in accordance with the law of 5 May 1872 on commercial pledges, ie, as of the moment the secured debt falls due, the pledgee must notify the debtors of the pledgor of the default. As from that moment, these debtors must pay the amounts of the pledged receivables to the pledgee. The pledgee is allowed to set off the payments against the secured debt. If such debtor refuses to pay, a court order must be obtained.

Enforcement of pledges over financial instruments

Unless the pledgee and pledgor agreed otherwise, the pledgee can immediately sell the pledged financial instruments upon the occurrence of default, without any prior notification or court permission and notwithstanding any insolvency proceedings.⁶⁰ If the pledgor, receiver or administrator finds that the price that was paid for the financial instruments was too low, he will have to start legal proceedings before the court to obtain compensation for the damages suffered due to the failure of the pledgee to find a buyer for the financial instruments that would have paid a correct price.

Enforcement of pledges over bank accounts

Unless the pledgee and pledgor agreed otherwise, the pledgee can immediately become the rightful owner of the amounts that are present on the pledged bank account, notwithstanding any insolvency proceedings, seizure of the financial instruments or any other form of concursus creditorum.⁶¹

G. INTERCREDITOR ARRANGEMENTS AND SUBORDINATION

Freedom to contract

Given the principle of freedom to contract, the parties are free to determine their mutual rights and obligations under the intercreditor agreement.

This implies that clauses that are drafted under English law, can also partly be used in Belgium.

The same remarks made above apply.

H. CAVEAT: LENDER'S LIABILITY

The basic principle

Contractual lender's liability will occur in the event of non-compliance by the lender with the contractual terms of the facilities agreement or the rules of professional conduct. Even if the contractual terms are complied with, the use of contractual rights can give rise to contractual liability in the event of 'abuse' of contractual rights. Case law of the Supreme Court shows that, even if the withdrawal of funds without any notice period is within the scope of a facilities agreement and does not therefore constitute contractual misbehaviour, the lenders may incur liability. Such is the case if the disadvantage or damages resulting for the debtor are in disproportion to the advantage obtained by the

⁶⁰ Section 8 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *B.S.* 1 February 2005.

⁶¹ Section 9 of the Act of 15 December 2004 regarding security interests over financial instruments and various tax rules regarding security interests over assets and the lending of financial instruments, *B.S.* 1 February 2005.

lenders. The lenders must therefore at all times exercise their contractual rights in a normal and reasonable manner, and may not abuse their (contractual) rights.

The use of a short notice period for mandatory repayment may in certain circumstances be considered by the competent court as an abuse of law. The court will base its decision on the factual circumstances including the respective (financial) situations of Belgian companies. If the borrower agrees with the withdrawal, it will be difficult to successfully invoke contractual liability or abuse of contractual rights vis-à-vis the lender.

Tort liability

A lender may incur lender's liability under the general rules of Belgian tort law if it withdraws (eg, by way of acceleration or by blocking further drawings) its funds or does not terminate its loans. This tort liability of the lender will in both cases be judged according to the following criteria:

- a breach committed by the lender (untimely withdrawal of the loan or unjustified continuation of the loan);
- the breach resulted in damages to the debtor or to third parties; and
- a causal link between the breach and the damages.

Two separate hypotheses have to be distinguished in this respect: tort liability to (i) the debtor and (ii) to third parties.

Tort liability to the debtor

As mentioned above, the liability of the lenders to the debtor is, in principle, a contractual liability. However a tort liability can occur if the following three conditions are met.

- (1) The lenders must have committed a non-contractual breach. Even in the absence of a contractual breach, any action or failure to act when a normal and reasonable lender would have done differently can constitute a tort. The competent court will have to consider (i) the specific circumstances at the time of action or failure to act by the lender and (ii) the assessment made by the lender. It is important to note that the level of scrutiny which the courts can apply is disputed in Belgian case law: in the event of a tort liability, the power of scrutiny by the courts is in-depth as opposed to a marginal scrutiny which applies in the event of contractual liability. Given that in any case the lenders also have a contractual relationship with the borrower, certain case law opines that the scrutiny in the event of tort should be limited to a marginal one. In any case, in order to avoid lender's liability, the lender will have to monitor the financial situation of Belgian companies, in order to detect important facts that might influence the financial position of such companies. Hence, the position of the lenders is a delicate one: on the one hand not terminating the loan and thereby creating for third parties an appearance of creditworthiness can constitute a tort. On the other hand, if the lender without any notice or with short notice withdraws the funds, such action may also constitute a tort.
- (2) The breach must result in damage (eg, insolvency of the borrower).
- (3) A causal link between the breach and the damages is necessary.

If the withdrawal of the funds mentioned above is held to be a tort, the debtor still has to demonstrate to the competent court that the sudden withdrawal left the Belgian borrowers/obligors with no time to find any other solution which would have been available in the event of a sufficient notice. Belgian case law shows, however, that it is difficult to demonstrate the damages and the causal link.

There is no liability towards the debtor for withdrawing the funds if the borrower agrees to the withdrawal provided that the said approval is not invalid.

Tort liability to third parties

The tort liability of the lender to third parties is also subject to the three conditions mentioned above. The subtle balance between the maintaining and the withdrawal of the funds is even more difficult to achieve with respect to the lender's liability towards third parties.⁶² In order to avoid liability to third parties, any action must be carefully considered.

The maintaining of funds may be considered as a breach vis-à-vis a third party, provided that on the basis of objective information the debtor could no longer be considered as creditworthy. If the bank is aware or should be aware of the fact that the company which demands a loan is destined to become insolvent, the bank should refuse to grant a loan.⁶³ Third parties have to demonstrate that the omission of the lender created an appearance of creditworthiness

⁶² G Schrans and R Steennot, *Algemeen deel van het financieel recht*, in *Reeks Instituut Financieel Recht* 5, Intersentia, Antwerp, 2004, 469, no 615.

⁶³ Bergen 20 September 1999, *JLMB* 2000, 1684; Luik 10 November 1998, *RRD* 1999, 31; Kh Brussels 2 June 1998, *Rev Rég Dr* 1988, 195.

which induced them to start or continue to deal with the debtor. The behaviour of the lender shall be compared with the behaviour of a 'normal prudent professional'.

To obtain objective information with respect to borrowers, lenders have to monitor during the term of the facilities agreement the financial situation of Belgian companies, which should include a review of the annual accounts and the annual auditor report. The said monitoring by lenders should not be continuous as it may result in shadow management of the Belgian company. The lenders must therefore avoid intervening more than necessary in the decision-making process of the Belgian company.⁶⁴ The latter situation could give rise to lender's liability and shadow directors' liability.

As soon as the lenders are convinced that the situation of the Belgian company is hopeless, based on agreed events of default, the lenders must withdraw the funds and thereby terminate the facilities agreement in order to avoid damage to third parties by keeping up the appearance of creditworthiness. Furthermore, the termination letter must mention the reasons and, in order to avoid liability to third parties, a notice period or a gradual reduction of the funds should be provided. It is important that the debtor should be given a reasonable period to seek alternative sources of financing.

Impact of bankruptcy on lender's liability

The receiver of the Belgian insolvent company may request the court to declare the withdrawal of funds unenforceable against the insolvent estate in the following (non-exhaustive) situations:

- a payment made in the hardening period for debts due, provided it can be proved that the lenders had knowledge of the fact that the Borrower had ceased to pay its debts; and
- regardless of any declaration by the commercial court of a hardening period, transactions where it can be demonstrated that they were entered into with fraudulent prejudice to a third party.

In the event that the withdrawal of the funds by the lender falls within one of the above (or any similar) situations, such withdrawal cannot, as a rule, be enforced against the bankrupt estate, even if the debtor agreed with the withdrawal.

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About the Author



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⁶⁴ G Schrans and R Steennot, *Algemeen deel van het financieel recht*, in *Reeks Instituut Financieel Recht 5*, Intersentia, Antwerp, 2004, 472, no 621.