
Denmark

Financial Assistance

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INTRODUCTION

This guide sets out an overview of the Danish law on financial assistance, as currently regulated by the Danish Companies Act (Consolidated Act no. 1952 of 11 October 2021) (the Companies Act) in respect of private limited companies (ApS) and public limited companies (A/S).

GENERAL OVERVIEW

What are the origins of the regulation of financial assistance in Danish law?

The current Danish restriction on financial assistance has its origins in Article 23.1 of the Second Company Law Directive of 13 December 1976 (77/91/EEC), which was implemented in Danish law by Act no 282 of 9 June 1982. However, Danish law already prohibited financial assistance prior to the implementation of the Second Company Law Directive.

With the entry into force of the Companies Act, the regulation of financial assistance was inserted in sections 206 and 213–214 of the Companies Act. At the same time, the amendments to Article 23 effected by Directive 2006/68/EC (relaxing the prohibition on financial assistance under certain circumstances) were implemented in sections 207–209 of the Companies Act.

What should be understood as financial assistance under Danish law?

The making of loans, granting of security or in any other way making available funds by a company to a third party for the purpose (directly or indirectly) of purchasing or subscribing for shares in the company or a direct or indirect parent company of the company.

Is financial assistance generally permitted under Danish law?

As a general rule, subject to the below exceptions, Danish law does not permit financial assistance in respect of limited liability companies.

Are there any exceptions under Danish law as regards the general prohibition of providing financial assistance to third parties?

There are four main exceptions to the prohibition on financial assistance under Danish law:

Debt pushdown

Debt incurred by a parent company and used to acquire a target company (in respect of which it would be illegal for the target company to grant security, guarantees or other financial accommodation) can legally be pushed down into the target company through the use of a dividend distribution from the target company. This is often referred to as debt pushdown.

Legal financial assistance

Pursuant to sections 206(2)-209 of the Companies Act, a Danish company is generally permitted to provide financial assistance in connection with an acquisition of or subscription for shares in the company or a direct or indirect parent company, provided that the amount of the financial assistance does not exceed the company's distributable reserves at the time when the financial assistance is rendered. Certain procedural requirements must also be complied with.

Employees

To the extent that financial assistance is provided for the purpose of purchasing shares in the relevant company (or a direct or indirect subsidiary thereof) from or to the employees of the

company or its subsidiaries, it is exempted from the prohibition on financial assistance, provided that the purchase is part of a general (incentive) programme open to all employees and that only distributable reserves are used.

Banks and mortgage lending institutions

The prohibition on financial assistance does not apply to banks or to mortgage loans from Danish mortgage lending institutions (*realkreditinstitutter*).

What are the consequences of providing financial assistance?

Civil penalties

Any illegal financial assistance must be repaid/re-transferred, together with interest calculated at a statutory default rate. If repayment or re-transfer is not possible, the persons having participated in the granting of illegal financial assistance may incur personal liability.

Fines

The persons having participated in the granting of illegal financial assistance will be subject to punishment in the form of fines under section 367(1) of the Companies Act.

LIMITED LIABILITY COMPANIES

General rules

Pursuant to section 206 of the Companies Act, the making of loans, granting of security or in any other way making available funds by a company to a third party for the purpose (directly or indirectly) of purchasing or subscribing for shares in the company or a direct or indirect parent company of the company is illegal.

When assessing the scope of the prohibition in a cross-border context, the following should be noted.

Foreign parent companies of Danish companies

When considering whether a foreign entity would constitute a parent company for the purposes of the prohibition on financial assistance, the Danish Business Authority is of the view that an analogy can be drawn from Executive Order no. 85 of 30 January 2020. This defines parent companies for the purposes of the rules on shareholder loans in sections 210–212 of the Companies Act.

On this basis, a foreign entity will constitute a parent company for the purposes of the Danish prohibition on financial assistance if:

- it is in a form similar to the Danish limited company (A/S or ApS) or limited partnership company (P/S) – this would be the case for the types of entities listed in Article 1 of the First Company Law Directive of 9 March 1968 (as amended) (68/151/EEC); and
- it is domiciled in a European Union or European Economic Area Member State, or any one of Australia, Canada, Israel, Japan, New Zealand, Singapore, South Korea, Switzerland, Taiwan, the United Kingdom or the United States.

Foreign subsidiaries of Danish companies

According to the administrative practice of the Danish Business Authority, the Danish financial assistance rules extend not only to Danish limited liability companies but also to direct or indirect foreign subsidiaries of Danish limited liability companies. In the eyes of the Danish

Business Authority, if a foreign subsidiary of a Danish company is proposing to enter into a transaction which is legal under the laws of the foreign jurisdiction in which that subsidiary is incorporated, but which would constitute illegal financial assistance if that subsidiary had been incorporated in Denmark, the directors of the Danish parent company will risk criminal liability if they do not use their control over the foreign subsidiary to seek to stop the transaction.

The practice of applying the Danish financial assistance rules extraterritorially is much debated and highly criticised by most Danish legal scholars and finance law practitioners. There is, however, little doubt that it remains the view of the Danish Business Authority that this particular set of rules applies extraterritorially. It is therefore unlikely that the position of the Danish Business Authority will change in the absence of clear case law overturning the Authority's view or an express change in the Companies Act.

Exceptions to the applicability of the general rule

There are four main exceptions to the prohibition on financial assistance under Danish law:

Debt pushdown

It has been accepted by the Danish courts for several years that debt incurred by a parent company and used to acquire a target company (in respect of which it would be illegal for the target company to grant security, guarantees or other financial accommodation) can legally be pushed down into the target company through the use of a dividend distribution from the target company. This is often referred to as debt pushdown.

Debt pushdown is dependent upon there being distributable reserves available in the target company at the time of the debt pushdown. The amount of debt which can be pushed down into the target company at any time is limited to the distributable reserves of the target company at such time.

The basic structure of a debt pushdown will usually be that within the same business day the following takes place in sequence:

1. The commitments of the lenders under the acquisition facility are increased by an amount equal to the amount of debt to be pushed down.
2. The target company draws down funds under the acquisition facility (often under a separate tranche thereof) corresponding to the increased commitments.
3. The target company distributes a dividend to the parent company equal to the amount drawn down by the target company.
4. The parent company uses the dividend received to prepay (part of) the acquisition facility.
5. The commitments of the lenders under the acquisition facility are reduced back down to their original level.

The effect of the debt pushdown is that (part of) the acquisition debt is, through a dividend distribution, pushed down into the target company and becomes the target company's own debt. Apart from reducing the structural subordination of the acquisition lenders, this has the significant benefit that the target company can legally secure and guarantee the pushed down debt.

It should be noted that, under section 184 of the Companies Act, if the Danish target company is listed on a stock exchange, it must be disclosed in the public offer document if the purchaser intends to make the target company distribute dividends within 12 months from the acquisition. If a debt pushdown is contemplated within 12 months of the acquisition of a listed company, the intention to complete the debt pushdown must be disclosed publicly. Failure to disclose the intention to distribute dividends will result in an automatic prohibition on dividend distributions in the target company for the first 12 months, except to the extent that the distribution is based on

an improvement in the target company's financial position which could not have been foreseen at the time of preparation of the offer document.

Legal financial assistance

In 2009, Denmark implemented the amended Article 23.1 of the Second Company Law Directive which provides for legal financial assistance under certain circumstances. The provision is implemented in sections 206(2)–209 of the Companies Act. These provisions generally allow a Danish company to provide financial assistance in connection with an acquisition of, or subscription for, shares in the company or a direct or indirect parent company, provided that the amount of the financial assistance does not exceed the company's distributable reserves at the time when the financial assistance is rendered.

There are several procedural requirements that are associated with the use of legal financial assistance. This is the main reason that the instrument so far has not gained widespread use in the Danish market compared to traditional debt pushdowns. Among the most onerous procedural requirements are:

- publicity through a requirement that the basis, purpose and terms of the financial assistance be described in a statement by the company's management to the shareholders, which will be made public; and
- increased exposure to director liability – it is a requirement that the management of the company ensures:
 - that the financial assistance is granted on arm's length terms (which in itself will often be difficult to verify with any significant degree of certainty); and
 - that a proper credit assessment is conducted of the beneficiaries of the financial assistance. If the financial assistance takes the form of a guarantee or security for the benefit of an external financier of the acquisition, both the purchaser and the financier are required to be credit assessed by the company.

Employees

To the extent that financial assistance is provided for the purpose of purchasing shares in the relevant company (or a direct or indirect subsidiary thereof) from or to the employees of the company or its subsidiaries, it is exempted from the prohibition on financial assistance.

The exemption is limited to general employee incentive plans and excludes the directors and executive officers of the company. It should further be noted that the exemption would not cover financial assistance for the purpose of acquisition of shares in a parent company; such an incentive plan would have to be financed by the parent company to be exempt.

Banks and mortgage lending institutions

The prohibition on financial assistance does not apply to banks or to mortgage loans from Danish mortgage lending institutions (*realkreditinstitutter*). It is the view of the Danish Business Authority that the primary purpose of this rule is to ensure that ordinary loans or mortgage loans made by banks or mortgage lending institutions do not constitute illegal financial assistance just because the borrower is or becomes a shareholder of the relevant bank or mortgage lending institution.

For the same reason, the Authority reserves the right to take action against transactions where there is a very close link between the granting of the loan and the acquisition of shares in the relevant bank or mortgage lending institution.

Notwithstanding the abovementioned exceptions, there has been a general tendency for the Danish Business Authority to prohibit corporate actions that, although according to their terms are in compliance with the law, in the opinion of the Authority appears to primarily have the

purpose of circumventing the ban on financial assistance. An example from recent practice would be the use of free reserves created by forgiveness of intra-group loans, connected with an acquisition, to pay out dividends (effectively mainly reflecting free reserves in the acquired company) following a merger with the acquired company.

CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE

Civil penalties

Any illegal financial assistance has to be repaid/re-transferred, together with interest calculated at a statutory default rate, provided that any security granted in favour of third parties and constituting illegal financial assistance will be binding on the company if the third-party beneficiary was in good faith about the fact that the security constituted financial assistance.

Liability of persons having effected financial assistance

If repayment or re-transfer as set out above is not possible (eg, because the borrower of a loan constituting illegal financial assistance has gone bankrupt), the persons having agreed (on behalf of the company) to provide or assisted in effecting the financial assistance will be personally jointly and severally liable for any loss suffered by the company as a consequence of their actions.

Pursuant to Danish case law, advisers (eg, legal counsel) are not covered by the reference to persons having assisted in effecting the financial assistance. They will therefore only be liable to the extent they have acted with culpability under the applicable professional liability standard.

Fines

The persons having participated in the granting of illegal financial assistance will be subject to punishment in the form of fines under section 367(1) of the Companies Act.

OTHER RELATED MATTERS

Merger of the purchasing company and the target company following a debt-financed acquisition

Where an acquisition of a target company has been financed (in part or in full) by moneys borrowed by the purchasing company, the general rule under a consistent administrative practice from the Danish Business Authority is that a subsequent merger between the target company and the purchasing company will be prohibited. This is because it would, in effect, constitute financial assistance as the creditors of the acquisition debt would obtain a direct claim against the assets of the target company.

An exception to this rule applies where the subsequent merger generally complies with the following criteria:

- it is prompted by significant business reasons (and not the desire to make the target company's assets available to the creditors). In recent practice, the Danish Business Authority has tightened this requirement so that:

- only business reasons that have arisen *after* the acquisition may be taken into account, and
- operational benefits such as potential synergies are required and it is not sufficient to point to a merger reducing costs by consolidating the corporate structure;
- it was not contemplated at the time of, or in connection with, the acquisition;
- at least a couple of years have passed since the acquisition; and
- it is not necessary to service the acquisition debt.