

The Restructuring of Danish Business Activities

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Introduction

Many foreign companies with business interests in Denmark organize their Danish business activities through incorporation of fully owned subsidiaries in the form of private limited companies¹ or public limited companies.²

During recent years, a number of limited companies have met dire financial straits due to the general recession of the Danish economy and have found themselves in need of financial support from their respective parent companies.

Regardless of whether the conclusion of the parent company, based on strategic and financial considerations, is to shut down or continue supporting its Danish subsidiary, such conclusions have legal impacts that need to be considered during the evaluation process.

For instance, in a shut-down or down-scaling of the activities, attention must be given to the employees of the company, the position of the creditors and the potential liability of the management responsible for carrying out the decisions taken. In a continuation of support to the subsidiary, e.g. by way of loans, debt cancellation or conversion of debt into share capital, attention must be given to tax implications, etc.

Even if the financial situation of the subsidiary cannot be turned around, the parent company may want to continue the operations.

In the following we will focus on the possibility of dissolving the debtor subsidiary of the parent com-

pany and restructuring the operations by way of a transfer of the business. The transfer may be made to an 'acquiring vehicle' incorporated for this purpose by the parent company.

Restructuring by way of a business transfer

The shareholders or managers of an insolvent company are entitled to purchase the business. A transfer to the management or shareholder may, in the case of certain types of business, prove to be the best (or only) possible way of selling the assets, e.g. in the event of enterprises carrying out business within development of intellectual property rights such as software, biotech, etc. However, creditors will often find it odd that the same group of people carry out the exact same business, usually from the same premises, without paying the creditors.

Thus, special attention must be given to the terms of the transfer agreement, the implications for the creditors and the potential liability of the decision makers that may arise if the transaction does not meet the interests of the creditors or does not comply with the principles of Danish insolvency law. Moreover, such transactions may be invalidated³ in the event that the subsidiary goes bankrupt.

A business transfer may be effected before any formal insolvency proceedings have been initiated or in combination with suspension of payments or bankruptcy of the subsidiary as the following will show:

Notes

- 1 In Danish: *Anpartsselskab*. Approximately 65,000 private limited companies are listed in the register of the Danish Commerce and Companies Agency. The formation, management, dissolution, etc. of these companies are governed by the Danish Private Companies Act. The minimum share capital amounts to DKK 125,000 (approx. EUR 16,500). The management of the company may consist of (i) a director alone or (ii) a board of directors of at least three persons and a managing director. A private limited company may be owned by any number of shareholders. The liability of the shareholders is limited to the amount of capital injected by each shareholder.
- 2 In Danish: *Aktieselskab*. Approximately 30,000 public limited companies are listed in the register of the Danish Commerce and Companies Agency. The formation, management, dissolution, etc. of these companies are governed by the Danish Public Companies Act. The minimum share capital amounts to DKK 500,000 (approx. EUR 67,154). The management of the company shall consist of a board of directors (with minimum three board members) and a managing director. A public limited company may be owned by any number of shareholders. The liability of the shareholders is limited in the same way as in a private limited company. Only public limited companies can be listed on the Copenhagen Stock Exchange (CSE).
- 3 Invalidation proceedings shall be instituted by the estate within 12 months from the date of the bankruptcy order; see Section 81 of the Danish Bankruptcy Act. Also, proceedings may be instituted within six months after the trustee has been able to raise the claim. The invalidation rules of the Danish Bankruptcy Act are applicable in situations of bankruptcy and compulsory composition.

a. Business transfer as a going concern

In this context, a business transfer means that a legal entity transfers certain assets and liabilities, rights and obligations to another legal entity.

The advantage of a business transfer is that the profitable parts of the business may be transferred from the legal entity which is burdened with old large interest-carrying debt to a new legal entity which is presumed to have more capital resources for the continued operation of the business.

The disadvantage of a business transfer is that the transfer of agreements is subject to the consent of the business partner, since Danish law prescribes that a creditor must accept a change of debtor. The transferee may, therefore, face demands for guarantee commitments or other security in order for the business partner to be willing to accept a new legal entity as a party to the future business relationship. Especially, problems arise if the creditor has made prepayments for which no security has been provided. The fulfilment of the order is basically a violation of the order of priority of creditors provided in the Bankruptcy Act.

When considering a business transfer it should be determined, among other issues, whether the assets and liabilities are transferred at market value. Creditors of the selling business are anxious to have the business sold at the highest possible price, as this is likely to give them the highest dividends in a subsequent distribution. The buyer seeks the lowest possible price to secure the highest return on his investment. The starting point will generally be the prices offered by a competitor. It is vital that the buyer pays in cash or provides an irrevocable guarantee not allowing set-off. However, a set-off may be agreed upon if by the set-off the buyer assumes liabilities that rank as preferential claims in accordance with the order of priority.

It should also be considered whether employees should be included in the transfer. In the affirmative, it is necessary to observe the provisions of the Danish Act on Employees' Legal Position in Connection with the Transfer of Undertakings⁴ which implies (i) that the transferee is liable for all obligations to employees who have not left the enterprise as at the completion of the transfer and (ii) that the employees must be given notice. In consequence of these mandatory provisions, the transferor and the transferee should agree who is to give notice to employees, which employees should leave the enterprise before the transfer, what liabilities the transferee will assume⁵ and to what extent the

transferee should have a right of recourse against the transferor with respect to liabilities that are not assumed but nevertheless may be raised against the transferee. In the event that many employees are to be dismissed in connection with the transfer, the provisions of the Danish Act on Notice, etc. in Connection with Collective Dismissals⁶ must be complied with.

The transferee should arrange for a detailed review of the rights to the core business of the enterprise, including domain names, patents, licenses, copyrights, trademarks, telephone and fax numbers, etc. Special attention should be given to the processing of electronic registers of customers and electronic messages to customers that are subject to the Danish Data Protection Act.⁷ As a basic rule, data may not be disclosed without the consent of the customer and enterprises may not contact customers at their own initiative. Any violation of the statutory provisions is subject to punitive damages. Also, access to transfer computer programs and software rights may be limited.

A business transfer is exempted from value-added tax, provided however that both the transferor and the transferee are registered in Denmark for value-added tax purposes. There are no stamp duties in connection with a business transfer. However, the obligation to adjust for value-added tax⁸ on real properties and operating assets must be taken into account to avoid unintentional liabilities to the Danish tax authorities.

The transferee should arrange for application for registration with the Land Registry, the Danish Patent and Trademark Office, DK Hostmaster and the Danish Securities Centre of real property, vehicles, patents, etc., electronic claims, domain names, etc. in order to secure completion of the transfer.

b. Business transfer in case of suspension of payments

An insolvent company may suspend payments by notifying the bankruptcy court. During the period of suspension of payments the company is protected from legal enforcement by unsecured creditors.

A debtor who has suspended payments is debarred from making material transactions without the approval of the appointed supervisor. A transfer of the business or substantial parts thereof is considered a material transaction and, thus, the transfer is subject to the approval of the supervisor. In practice this is seldom an issue as the supervisor will usually be

Notes

4 In Danish: *Lov om arbejdstageres retsstilling ved virksomhedsoverdragelse.*

5 Salary/wage claims rank prior to other creditor claims.

6 In Danish: *Lov om varsling m.v. i forbindelse med afskedigelser i større omfang.*

7 In Danish: *Lov om behandling af personoplysninger.*

8 In Danish: *momsreguleringsforpligtelser.*

highly involved in the transfer of the business. Also, a business transfer is a transaction of particular substance (see Section 15 of the Danish Bankruptcy Act), and accordingly the creditors' ability to disapprove of the transaction must be observed. In practice, the business transfer agreement should include a condition precedent to the obligations on the part of the seller that the creditors will not disapprove of the transfer within seven days. If the notice period elapses without any objections having been received by the supervisor, the transfer may be considered final.

Prior to the transfer, it is advisable to record and value the assets to determine their volume and value. The recording and valuation must be carried out by professional nominees appointed by the Danish Ministry of Justice. Finally, the above-mentioned issues regarding business transfer as a going concern should be considered, as such issues are all relevant for a business transfer in case of suspension of payments.

c. Business transfer in case of bankruptcy

At the commencement of bankruptcy proceedings the court appoints a trustee. The trustee must inform the creditors' committee – if such a committee is appointed – of contemplated important transactions, but does not in principle have to wait for reactions or objections from the creditors. The difference in the right to make transactions during suspension of payments and during bankruptcy proceedings should be considered when the reorganization model is chosen.

Prior to the transfer, it is advisable to record and value the assets to determine their volume and value, as mentioned above. In addition, the recommendations and rules described above regarding transfer of business as going concern should be observed, subject to the following modifications with respect to employees.

Under the Danish Act on the Employees' Guarantee Fund,⁹ employees of enterprises that are dissolved or administered in bankruptcy have the right to payment of wage/salary claims and minimum compensation in case of termination of their employment. The Act on Employees' Legal Position in connection with Transfer of Undertakings is also applicable if the estate's transfer of activities includes non-dismissed employees.

In practice, the legal positions under the Act on the Employees' Guarantee Fund and the legal position under the Act on Employees' Legal Position in connection with Transfer of Undertakings are often combined, so that the transferee only assumes liabilities

towards employees equal to the employees' preferential claims against the estate. Until the date of the bankruptcy order, liabilities to employees may be fulfilled by the Employees' Guarantee Fund. However, in cases where the transfer is de facto effected before the bankruptcy, the Employees' Guarantee Fund is likely to deny payment and, thus, a risk arises that the transferee will be met with unsettled claims from employees arisen prior to the bankruptcy.

d. Establishment of a subsidiary (hive-down)

This model can, in short, be described as a business transfer as mentioned above except for the fact that the business is used as a non-cash contribution into a wholly-owned subsidiary of the debtor and the debtor's subsidiary pays for the assets by issuing new shares. The purchase price may also be paid in the form of an instrument of debt.

The net value of shares should correspond to the net value of the assets and liabilities that previously belonged to the debtor and, consequently, the legal rights of creditors and business relations are not prejudiced.

The advantage of this model is that the viable parts of the business are hived off into an enterprise that has a normal management legally competent to transact business and is not affected by suspension of payments or bankruptcy proceedings of the debtor company. Another advantage is that by means of the transfer, the debtor company has made sustainable operations ready for sale. The debtor's subsidiary is likely to be in a better position to obtain financing from the ultimate parent company, banks and/or creditors as the share capital is intact, the liabilities are limited and the assets or shares can be disposed of as collateral.

In the case that the debtor company is paid in shares, the debtor company may sell the subsidiary by way of a share transfer to the ultimate parent company or an 'acquiring vehicle' incorporated for this purpose. In the case that the purchase price is settled by an instrument of debt, the debtor company will receive payments according to the terms of the instrument. The revenue will be an asset eligible for inclusion into the debtor company for the purpose of distribution to the creditors by way of a compulsory or voluntary composition or a mere distribution of dividend in case of a bankruptcy.

The debtor company's business may be hived down while it is a going concern, while it has suspended its payments (subject to approval by the creditors), or while in bankruptcy.

Notes

⁹ In Danish: *Lov om Lønmodtagernes Garantifond*.