NVP

Nederlandse Vereniging
van Participatiemaatschappijen

WORKS COUNCILS AND PRIVATE EQUITY
PRACTICAL ADVICE

A new code of conduct for NVP members, clear information on the website and a guide for Works Councils. In particular, this guide is a great tool that Works Councils can use to their advantage. An initiative that deserves a follow up.

Wouter Koolmees
Minister of Social Affairs and Employment

Thanks to:

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WHY THIS DOCUMENT?

The Dutch Private Equity and Venture Capital Association (NVP) drafted this document for Works Councils of companies for which a private equity firm has become a shareholder for the first time.

The legal basis for every Works Council is the Dutch Works Councils Act (WOR - Wet op de ondernemingsraden), which lists all rights and obligations. However, the Act does not provide guidance on how to proceed with a takeover: although for many Works Councils, a takeover by a private equity firm is new territory.

In this document, we map the different phases of a takeover and provide suggestions for what the Works Council can do. The recommendations are connected to the relevant WOR articles.

For more information about private equity and venture capital firms, see www.nvp.nl. Here you'll find more information about the updated NVP code of conduct and the Invest Europe Handbook of Professional Standards.

Should you require additional information, please do not hesitate to contact us.

Annemarie Jorritsma
Chair, Dutch Private Equity and Venture Capital Association (NVP)

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PARTICIPATION IN BRIEF

Private equity firms are investment companies that provide capital to unlisted companies. This is referred to as private equity for mature companies, and venture capital for young companies and start-ups. Private equity firms receive this capital from investors such as pension funds, insurance companies, and family offices.

Private equity firms invest with the aim of improving companies, especially in situations where business units become independent through business succession and growth. Besides capital, they also provide knowledge, experience, and a network. A private equity firm often invests in the best performing companies. If a private equity firm becomes a shareholder in the company, this is a sign that your company is such a company, or will soon be in the future.

Businesses with a private equity firm on board often put even more focus on their most promising business activities: they concentrate on the customers and products from which they expect the most growth and yield.

Therefore, a private equity firm as a shareholder offers opportunities. For example, they invest in new subsidiaries, internationalisation and improved and sustainable production.

Business activities that are not that successful may be improved or sold. Research shows that, on average, companies with private equity involvement perform better, show increasing employee satisfaction, grow faster and internationalise and innovate more than companies without private equity involvement. Successful co-operation between shareholders, directors and employees is critical for achieving this. By law the Works Council plays an important role in this. But a well-prepared Works Council is also a partner with whom a private equity firm wants to work for creating a better business, more employment opportunities, and jobs with a future.

After an average of four to seven years, the company is then sold to a financial buyer, another company, or is listed on a stock exchange. There is a high probability that the company's prospects will be better than when it was bought by the private equity firm. The return realised flows back into the pension funds, insurance companies and family offices that invested in the private equity firm's fund.

As a result, your company contributes directly to the pension of pensioners.

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CONTEXT

A takeover implies more than a transfer of control. A takeover involves the entire business. What happens to the strategy, what are the growth traits, where are investments made, will there be a reorganisation or other interventions? What happens to the governance, management and supervision? What about jobs?

What happens with the financing structure? These are all issues that a Works Council has a say in. The Works Council has a legislative right of advice with respect to a number of these decisions. This right is subject to a number of safeguards, including procedural safeguards. A few of these safeguards include: the right of advice must be promptly sought; with this advice, a Works Council must be able to exercise significant influence; there must be regular consultations on the proposed decision (including the reasons, the expected consequences and the measures taken to safeguard them); and the entrepreneur has a considerable obligation to state reasons.

It is also important that the Works Council has a fairly far-reaching right to information. The Works Council may determine to a large extent the information it needs to fulfil its task in this regard.

The Works Council may also bring in experts. It is important in complex situations to bring more balance to the knowledge asymmetry between entrepreneur and Works Council.

Not least, the Works Council may appeal to the Enterprise Division (Ondernemingskamer) against decisions which require the council's advice, for which the entrepreneur has deviated from the Works Council's advice.

Not all issues are dealt with at the time of the takeover. The request for an advice that lies ahead concerns the takeover and not all future plans. For future decisions that require an advisory report, management will have to submit a separate request for an advice to the Works Council. The buyer will not immediately take over the entire business. A Works Council would be well advised to establish its position and its powers in the takeover so as to ensure a good position during the transition and adjustment phase that often follows a takeover.

That could be achieved for instance by attaching conditions to the advice, establishing rules on how they will work together in practice, or by making arrangements, whether temporary or permanent, to ensure greater involvement of the Works Council in the first stage following the takeover.

In short: The Works Council has a solid, legally entrenched position and an arsenal of powers.

The important issue here is that these powers should be exercised "with caution." The exercise of these powers should, as far as possible, promote the interests of both employees and the company over the long term.

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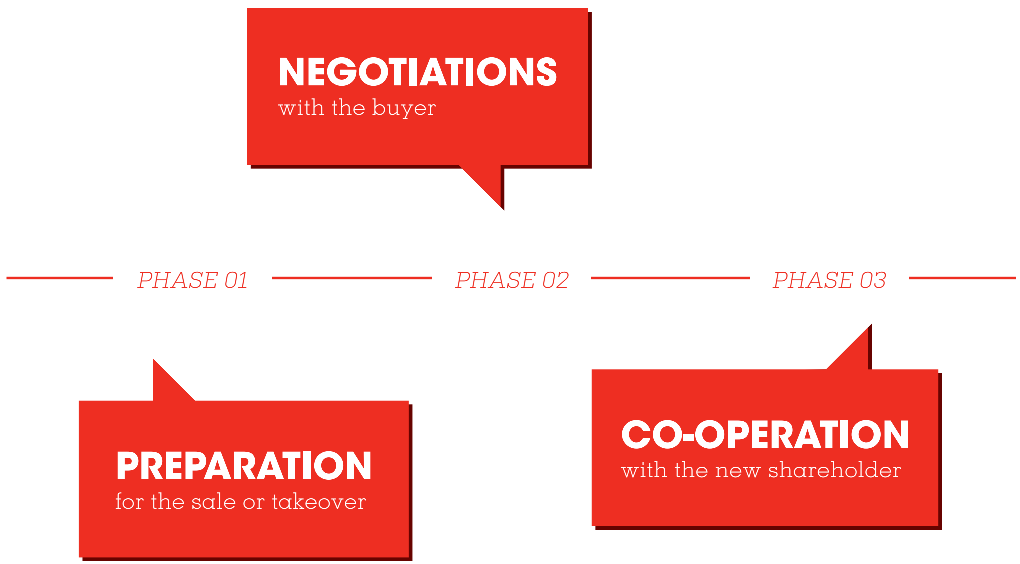
BUSINESS TAKEOVERS ARE ABOUT PEOPLE

The Works Council can do a lot before there is even talk of a takeover. A business takeover is about people. It is also a major event that is not an everyday occurrence. It is therefore important that the Works Council be able to function well in the event of a takeover. Works Councils can do a lot beforehand to optimise their overall structure and functioning. Most Works Councils have a good relationship with the board, management and the supervisory board, but it is still important to invest in this relationship. It is also important to continue to invest in relationships with shareholders and other stakeholders. Before there is even any talk of a takeover, it is important that essential conditions be determined for the process to be successful.

A roadmap in the event of a takeover should be discussed with management. This creates mutual clarity as to what management and the Works Council can expect from each other should a takeover come to pass. Build a good relationship with stakeholders

There are three phases to a takeover - a well-prepared Works Council can be actively involved throughout all three phases.



PHASE 01

PREPARATION FOR THE SALE OR TAKEOVER

The sale of a business or business unit does not come out of thin air. Often, such a scheme is the result of strategic (re)thinking or is based on grounds of business succession. In connection with, among others, competitive sensitivity and the possible unrest within the company, a board will tend to inform as few parties as possible about a potential plan for a sale. Experience shows that the likelihood of a leak is real. A potential sale is – especially in a family business – also a growth process.

However, the Works Council can ask management to keep it informed on the business' strategic options and can proactively share its strategic vision with the board. In realising its role, the Works Council must recognise and take account of the company's interests.

Examples of strategic questions are:

- How will the company grow?
- Does it need to expand its business activities or just sharpen its focus and go back to the core?
- Do they need to internationalise?
- What business activities should be improved or sustained?
- What activities should be phased out?

Following on from this, decisions are made regarding financing.

Questions that are then answered are:

- Does the business have sufficient capital to realise its plans?
- Does the business have adequate financial instruments to carry out its plans?

Possible options include:

- It continues independently
- It goes public
- It can divest a unit
- It can make acquisitions
- It can grow organically
- It can seek new or different shareholders
- It can seek better or more appropriate financing
- It can allow itself to be taken over

In the event of a takeover, the question is: What would the advantages and disadvantages be of this type of buyer? There are financial and strategic parties. Which new owner (and what type) would be best for the company for achieving the new strategy? If the Works Council is consulted, it could give its advice on, what type of buyer it believes would be best suited to ensure the continuity of the company, permit employment opportunities and allow for further growth and development, for example. This also applies to the issue of what the various potential buyers can contribute - besides capital - to the realisation of the strategy envisaged by the Works Council. By exercising its right of advice, the Works Council can become involved in strategic considerations

Some examples:

- Private equity firms not only provide a cash injection: they come with knowledge of and experience in specific situations and issues, and a network, including an international one, of managers, consultants and experts who can help the business achieve a particular strategy. The Works Council may indicate to the board what it believes are important added values.
- Private equity firms often choose to focus on

businesses' strengths. In terms of core activities, a plan is usually developed to further growth. For business units that do not fit within the scope of this plan, another plan is drafted. The Works Council can ask the board to include in its evaluation the candidate buyers' track record on growth, internationalisation and other issues which the Works Council believes are important to business and employment continuity. The board may also be asked to gain insight into potential buyers' vision for future employment, working conditions, etc. and how it will address these issues.

- If the list of potential buyers includes international private equity firms, the board may be asked to focus on the extent to which the potential buyer is familiar with the customs and practices in Europe and/or the Netherlands. By exercising its right of advice, the Works Council is able to be directly involved in discussions about strategic options and take account of certain situations in the decision-making process.

Recommendations

1 Make use of the legal framework that exists in this preliminary phase: the bi-annual consultations on the business' state of affairs (Art. 24 of the WOR), the right of advice for the formulation of an advisory opinion by an outside expert on matters relating to the advisory report (Art. 25 paragraph 1(n) of the WOR) and the economic and financial information (Art. 31 ff WOR).

2 Ensure that the Works Council has an idea of the business' strategic options, if any, and what the consequences for employees and other stakeholders would be. The Works Council should make time for this process and, if need be, ask for additional time for questions such as:
   a. What is the Works Council's view of the future of the company?
   b. What does the Works Council see as being the most difficult decisions?

3 See above for what is good for the company. What is most important is the continuity of the company. Intervention or measures may be required.

4 If a sale to a private equity firm is a viable option, make sure the Works Council knows what private equity firms are and how they work.

5 Private equity firms usually require board members to invest their own money. There sometimes exists the option for a broader group of employees to participate financially. This can be explored together.

6 Gather experiences from Works Councils that deal with, or have dealt with, private equity firms.

7 Try to make arrangements with management on how it will proceed if a buyer has to be chosen and how the Works Council will be kept informed. These arrangements may be enshrined in an agreement (Art. 32 WOR).

8 Advise the board as to what considerations regarding potential buyers the Works Council would like to see included in talks with candidates. Matters relating to the continuity of the business and jobs, but also issues relating to future financing or other matters over which the Works Council has advisory powers at a later stage.

9 Ask the board to provide subsequent feedback as to how the Work Council's considerations will be incorporated into discussions.

10 Ask the board to provide insight into the considerations designed to continue the process with the party chosen and with the serious alternative bidders.

11 Be aware of the statutory duty of confidentiality which may be imposed on the members of the council, provided it is well defined (see Art. 20 WOR).

PHASE 02 NEGOTIATIONS WITH THE BUYER

If exclusive negotiations are underway with a buyer, then it is time for a legal opinion on the accession of the new shareholder and possibly attracting new loans. The preparatory work carried out will now bear fruit. Ensure that the entire Works Council is now on board. Although the preparation for a sale can be long, the process can be accelerated at this stage.

Recommendations

1 Arrange with the board that the candidate buyer speaks with the Works Council in the presence of the board and may be questioned by them regarding:
   a. A business plan outline
   b. The knowledge, expertise and network that the investor brings.
   c. Predicaments and difficult decisions foreseen, how they will handle them and how the Works Council will be involved.
   d. Financial projections, policy regarding dividend payments and refinancing.
   e. The shareholder structure and any employee participation.

2 Potentially make contact with the Works Councils of the buyer's portfolio companies.

3 During negotiations, plans are made to establish the governance of the new company. Let an experienced legal adviser provide advice and try to make arrangements with the buyer on:
   a. Future co-operation
   b. The Two-tier Board System (Structuurregime) (in short: the special regime for large companies, that ensures Works Council have the right to nominate up to one-third of the members of the Supervisory (non-executive) Board; this applies to a limited number of the acquisitions on the agenda).
   c. Supervisory Board (see especially Art. 2:158 and :268 paragraph 6 of the Burgerlijk Wetboek (BW) or Civil Code).

4 The Works Council has a right of advice regarding the financing of the company (Article 25(1)(h), (i) and - especially - (j) WOR, depending on the financing structure). It is advisable to have a financial expert review the proposed financing structure. High borrowing costs are not necessarily harmful for a company, but they must be evaluated in relation to the expected cash flows and the business plan. A few points that must be considered:

a. The duration of the various loans and the distribution of repayments over the years.
b. The interest rates in which, in the case of variable rate loans, the costs and instrument risks also have to be examined to hedge the interest rate risk (e.g. interest rate swaps).
c. The provision of customary collateral by the business (e.g. pledging of assets).
d. How much financial room exists between the minimum financial targets (financial covenants) agreed upon with the funders and the proposed business plans. Is there sufficient room to absorb setbacks?

5 If the company receives advice regarding the financing structure, it is good practice to carefully consider that advice.

6 If it is suggested that, in addition to bank loans, shareholder loans should also be used, ask for advice as to the pros and cons of using shareholder loans versus cumulative preference shares.

7 Make sure you are informed to reach a considered opinion. This can also be done by the private equity firm (which also benefits from a solid financial structure) and/or by an outside expert.

8 Decisions need to be made under time pressure. Keep a cool head, make sure the Works Council is consulted where needed, keep seeing the big picture and continue to see the company's interests as being most important. If the Works Council objects to the proposals in whole or in part, it may attach terms and conditions to the advice. In this event, the Board may, in agreement with the buyer, decide to incorporate the proposals or, failing that, it must implement its decision within one month. If the Board does not adhere to the suspension period, the Works Council can go to the Enterprise Division (Ondernemerskamer) (Articles 25 and 26 WOR).

PHASE 03
CO-OPERATION WITH THE NEW SHAREHOLDER

The private equity firm views the cooperation with management and the compagny as a partnership, with ambitious goals and an ambitious plan. If the sale is completed, the new co-operation starts and the plans can be implemented and deployed in the realisation of growth ambitions.

Recommendations

1. Agree as to how often the Works Council is to be informed.

2. Ensure compliance with the WOR.

3. Mutually voice important communications to the rest of the company.

4. Alert the Works Council on issues facing the organisation or in the market and discuss them proactively with management.

5. There may be greater need/occasion for periodic meetings in substantive and procedural terms. Agree on how often and between who (Works Council, board, supervisory board, etc.) the meetings are to take place.
   a. Ensure that you know what the growth drivers are.
   b. Regularly discuss the progress of the business plan.
   c. Review the state of financial affairs.

6. Maintain good relations with the shareholder. Private equity firms benefit from strong co-operation and will fully and unequivocally support this initiative.

7. The new ambitions and plans can put pressure on management. However, the Works Council can continue to be effectively involved by providing effective and timely input.

8. Management (and possibly a broader group of employees) may be a shareholder, which entails an extra dimension for the Works Council. Management and employees who are shareholders may be more focused on the company's growth and improvement, which may entail additional risks and opportunities.

9 The earnings model of a private equity firm should be taken into account. Their goal is to create value for investors in the private equity firm's fund, such as pension funds and insurers. Private equity firms do this by strengthening their portfolio companies. This usually happens by letting companies grow, innovate and internationalise, but it can also mean the reorganisation of parts of the business.

10 What should the governance structure look like if management has shares or if shareholdings are more widely introduced in the company? Arrange for a thorough examination of tax considerations.

11 Private equity firms usually invest for a period of four to seven years and subsequently sell their stake in the company to another financial buyer, a strategic buyer (another company), or list the shares of the company on a stock exchange. You know this step is coming, so make sure to establish a roadmap/protocol.

05 TIPS FOR PRIVATE EQUITY FIRMS

1. Explain what private equity firms are and how they work.
   a. Features:
      i. Long-term active shareholders (four to seven years)
      ii. Sharpen focus to improve the business
      iii. Capital, knowledge and network
      iv. Align interests of investors, fund managers and the management of portfolio companies by making fund managers and managers invest and take risks with their own money involved. This means that there is potentially considerable personal downside for both the fund managers and management.
      v. The importance of a good reputation
   b. How does a fund work:
      i. Raising funds
      ii. Investing
      iii. Co-operating in practice
      iv. Selling
   v. Paying contributions and returns to investors Under conditions fund managers who invested get a share
   c. What could private equity mean for the company in question.

2. The public perception exists that the shareholders' interest is the only interest worth serving. Emphasise the relevance of the interests of other stakeholders.

3. Make clear what the difference is between private equity and hedge funds.

4. Eliminate uncertainties about jobs as soon as possible.

5. Involve the Works Council in plans.

6. Invest in facilities for employee participation (training sessions, knowledge sharing, etc.).

7. Encourage a situation where well-equipped individuals sit on the Works Council.

8. Know what is happening within the company. Speak with multiple levels within the company.

9. What is the private equity firm's view of co-operation with management, the supervisory board and the Works Council?

Want to know more?

Contact the Dutch Private Equity and Venture Capital Association (NVP).

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