

■ UPSTREAM SECURITY IN EUROPE

A concise overview of the issues arising in connection with
the granting and taking of Upstream Security in Europe



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■ INTRODUCTION

1. Increase in Cross-Border Financing

Financing transactions cross borders more and more often due to the increasing internationalization of lenders and borrowers. In recent decades, companies have increased their international operations. Thus, subsidiaries in various jurisdictions can be involved in financing transactions as borrowers, guarantors or security providers. For lenders the key benefit of cross-border financing is diversification. By spreading their activities over different countries, lenders are less exposed to individual domestic or foreign risks. This may in turn reduce the volatility of lending.

2. Security as Common Feature in Cross-Border Financing

Irrespective of jurisdiction, the first questions in financing are what type of security is available and what is the value of the security. Any loan is associated with some risk of default. Granting security is one method that has been used since the fourth century B.C. to reduce the risk borne by the lender in making a loan. The main purpose of the security is to give the lender some recourse if the borrower fails to meet the terms of the loan. However, the security can also be useful for borrowers. Borrowers who are perceived by lenders to be less credit-worthy are better able to access credit when they grant a security. Without a security, these borrowers would generally find their access to credits restricted. Secured loans usually offer lower rates, higher borrowing limits and longer repayment terms than unsecured loans.

3. Legal Issues in Connection with Upstream Security

Cross-border financing can present many traps for both borrowers and lenders. An array of legal issues is involved in structuring and negotiating cross-border financing transactions. One of these legal issues arises in connection with the granting and taking of upstream security. In many jurisdictions upstream security can be problematical. Often the risk of granting upstream security must be balanced with the actual or potential rewards. Sometimes the value has to be limited to the net asset value of the company providing upstream security. Additionally, there are prohibitions on the granting of financial assistance by a company in connection with the acquisition of its shares, or those of its holding company. The circumstances in which an upstream security may be granted vary greatly in different jurisdictions.

4. Aim of the Brochure

This brochure is designed to offer a concise and practical overview of the issues in connection with the granting and taking of upstream security in Europe. It is intended to give the reader an initial grasp of the different requirements and risks of granting upstream security, thus allowing the right questions to be asked of local counsel and proving an understanding of the responses and its implications. Accordingly, this brochure does not attempt to provide a detailed discussion of granting upstream security in each jurisdiction. The information in this brochure is not considered legal advice and should not be treated as such. The respective authors have developed the editorial content presented. Therefore, the sole responsibility for the content of this brochure lies with the respective author and P+P Pöllath + Partners does not assume any responsibility for the content of this brochure.

■ GLOSSARY OF TERMS USED IN THIS BROCHURE

This glossary lists and defines some of the terms used in this brochure. It shall serve to create a uniform understanding of these terms throughout the brochure.

TERM	DEFINITION
Upstream security	The granting of guarantees and asset security by a company to support loans incurred by a holding company or sister company of the relevant guarantor or security provider, respectively.
Corporate benefit	The directors of a company, which provides an upstream security, have a duty to act in what they consider to be the best interests of said company. They must ask themselves whether they can justify the company's securing another company's obligations.
Financial assistance	All kinds of financial support that expose a company to a risk which did not previously exist and thereby enable or support another person in acquiring shares issued by that company or those of its holding company.
Capital maintenance rules	All rules designed to ensure that a company obtains the capital that it has purported to raise and maintains said capital, subject to the exigencies of the business, for the benefit and protection of the company's creditors and the discharge of its liabilities.

24. Slovakia



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We have served both lenders and borrowers on all types of finance transactions, from simple and small to large and complex, for over 10 years. We are particularly experienced in representing both financial institutions and trading entities with their swaps and derivatives transactions.

Our attorneys have worked at prestigious European banking institutions and are pursuing advanced business and finance degrees.

QUESTION 1: Is granting upstream security in principle possible in your jurisdiction?

Yes

No

QUESTION 2: Are there any corporate benefit, financial assistance and/or capital maintenance rules that need to be observed in your jurisdiction?

Corporate benefit

Company benefit required

Group benefit sufficient

Financial assistance

Capital maintenance

QUESTION 3: What are the possible legal consequences of violating such rules in your jurisdiction?

Invalidity of security

Civil liability of

Director of company

Director of shareholder

Shareholder

Lender

Criminal Liability of

Director of company

Director of shareholder

Shareholder

Lender

QUESTION 4: Is it market practice in your jurisdiction to include limitation language and if so, what are in essence the legal consequences?

Yes

Legal consequences: N/a.

No

QUESTION 5: Are there any other measures required in your jurisdiction to avoid/minimize risks related with upstream security besides limitation language (e.g. shareholder approval, adequate fee etc.)?

Yes

No

QUESTION 6: Are there any exemptions or whitewash procedures in your jurisdiction?

Yes

No

QUESTION 7: Are there any differences depending on the legal entity of the security provider in your jurisdiction?

Yes

No

QUESTION 8: Comments/Specifics

- (1) Slovak law only provides explicit rules regarding financial assistance for stock corporations (akciová spoločnosť – a.s.), whereas no explicit rules exist for limited liability companies (spoločnosť s ručením obmedzeným – s.r.o.).
- (2) Security granted by an a.s. for the purpose of acquisition of its own shares or the shares of its holding company is void. There are minor exceptions for banks acting in ordinary course of business.
- (3) Directors of a Slovak companies are subject to a general obligation to act in the interest of that company (due care) in relation to all their actions on behalf of companies, including when granting security for the benefit of third parties.