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ARTICLE

The Dutch Draft Bill on 'Dutch Schemes Of Arrangements': A New Tool in Dutch Bankruptcy Law

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Synopsis

Dutch (bankruptcy) law lacks the possibility for financially distressed companies to efficiently propose a scheme to their creditors to prevent bankruptcy. Under current Dutch law, the general rule of freedom of contract prevents a debtor to cram down a scheme to its creditors, which could result in a continued existence of the company rather than formal insolvency proceedings such as bankruptcy or liquidation. As such, secured creditors cannot be bound by Dutch schemes. In this article, we discuss a draft bill introduced by the Dutch legislator and which introduces the possibility for financially distressed companies to propose a scheme to cram down their creditors. Inspired by American and English restructuring mechanisms, this draft bill contains elements of both the American Chapter 11 and the English Schemes of Arrangements. Following prior consultation procedures in 2014 and 2017, the Dutch legislator has recently submitted the draft bill to the Council of State for advice. The Dutch scheme is expected to come into force no earlier than 2020.

1. Dutch legislators' initiatives

1.1 Introduction

The Dutch legislator started a legislative programme in 2012 reviewing the Dutch Bankruptcy Act, which came into force in 1896. The Dutch Bankruptcy Act should develop in parallel with the market and the Dutch legislator therefore aims at adding a number of additional instruments and modernising some of the provisions of the Dutch Bankruptcy Act instead of fundamentally reviewing the Dutch Bankruptcy Act as a whole. The two most important (suggested) changes are the addition of (i) rules regarding so-called prepacks and (ii) rules regarding a scheme which can be adopted without opening formal insolvency proceedings (but under court supervision).[1] In this article, we will be focussing on the latter.

On 5 September 2017, the Dutch ministry of security and justice published a (revised) draft bill; the Act on the confirmation of a private scheme or *Wet homologatie onderhands akkoord* (the 'Draft Bill'), which will introduce the possibility in the Dutch Bankruptcy Act for financially distressed companies to, also outside of formal insolvency proceedings, cram down their creditors and shareholders in order to restructure their debts. Inspired by Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012[2], the American Chapter 11 and the English Schemes of Arrangements, the Dutch legislator follows the European trend to implement new bankruptcy tools in the Dutch legal landscape. This Draft Bill is already the second draft bill on this topic, addressing various concerns raised during previous formal consultation procedures. Possibly the Draft Bill will be further amended on some points but the overall expectation is that the global outline is set in stone.

1.2 Current practice under Dutch bankruptcy law

There are currently two main insolvency proceedings for companies, which may be commenced under the Dutch Bankruptcy Act; (i) bankruptcy (*faillissement*) and (ii) suspension of payments (*surseance van betaling*). Following these proceedings, a company can already scheme (*akkoord aanbieden*) its creditors, therefore being post insolvency mechanisms.[3] Such schemes are an agreement between a debtor and its creditor(s) and allow for the possibility to restructure unsecured, non-preferential, debts by implementing a scheme through a mechanism by which a majority of the creditors can bind a dissenting minority (cram down). The threshold for such cram down is, however, very high. Under Dutch bankruptcy law secured or preferred creditors cannot be compromised by a scheme and may

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1 See articles by V. Vroom and R. van Galen in previous issues of *International Corporate Rescue*.

2 And the Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (2016/0359 (COD)).

3 Schemes of Arrangements and Chapter 11 procedures are both pre-insolvency procedures.

therefore continue to enforce their security rights during insolvency proceedings. If the scheme is accepted by the creditors and sanctioned by the court, the estate will not be liquidated and the insolvency proceedings will be terminated. Because of the principle of freedom of contract and the fact that secured creditors cannot be crammed down, all amendments (maturity dates, prepayment schedules, shareholder structures etc.) require 100% consent. Therefore, Dutch restructurings are consensual deals, making Dutch schemes rarely successful in practice.

1.3 The Act on the confirmation of a private scheme

The Draft Bill implements some significant changes to the Dutch Bankruptcy Act. The key new feature of the Draft Bill is the fact that it, can be used to (also) compromise creditors with priority rights and secured creditors. As mentioned above, under current Dutch legislation this is not possible. Notable is also the incorporation of several features from the American Chapter 11 of the US Bankruptcy Code ("Chapter 11"), which offers financially distressed companies a wide range of rescue and/or restructuring options. The Draft Bill for example includes (i) a temporary stay, (ii) a best interests of creditors test and (iii) (a variation of) the absolute priority rule. Furthermore, pursuant to the Draft Bill, financially distressed companies can request the court to settle any disputes arising during the negotiations of the scheme. Finally, the Draft Bill grants a debtor the right to (re-)negotiate term of ongoing contracts, as well as the option to terminate an ongoing (long-term) contract if parties cannot agree on a variation.

2. The Draft Bill: a Dutch scheme with a lot of possibilities

2.1 Introduction

If a company foresees that it will no longer be able to pay its (due and payable) debts, it may propose a scheme to all or some of its creditors and/or shareholders, which can result in an amendment of their rights. The main idea behind the Draft Bill is that the debtor is in control and has the initiative to prepare and offer such scheme; this is comparable with the debtor-in-possession structure in Chapter 11. Court involvement is limited but courts can be approached at any time during the process if deemed necessary by the debtor or creditor.

The starting point of a scheme is that, in principle, the debtor takes the initiative to prepare a scheme. If the debtor does not make a proposal to his creditors and/or shareholders for a scheme, even though it is clear that this is the only way to avert an imminent bankruptcy, or if he does make a proposal but it is so defective that it cannot be considered a viable attempt, the Draft Bill allows creditors to initiate a scheme. In this situation, the creditor(s) may ask the district court to appoint a third party to draft a proposal for a restructuring plan and initiate a procedure that may lead to court confirmation of the restructuring plan. If the district court decides to appoint a third party, the debtor is obliged to provide this third party with all information and cooperation it may require in order to succeed in its task.

2.2 Set-up of a Dutch scheme

The debtor is free, in theory, to decide what to offer its creditors and/or shareholders and how to set up the scheme save for a number of (mandatory) procedural pre-conditions. The Draft Bill provides that a scheme can amend the rights and claims of all (classes of) creditors. This means that a proposed scheme may also lead to an amendment of the rights of the preferential and secured creditors.

One important obligation for the debtor is that it must include in the (draft) restructuring plan specific information, to ensure that the creditors and shareholders are able to form a considered opinion when called upon to vote on the restructuring plan. The included information should be sufficient for creditors (and the court) to make a proper assessment and to render a decision with respect to the restructuring plan but should also contain several pre-conditions such as the expected value of the company, the used valuation method but also information about the voting procedure.

Apart from changing the rights of creditors, the scheme may also amend the rights of shareholders. This introduces the possibility of a "debt for equity swap" under Dutch law.[4] There are many examples of a "debt for equity swap", but what they basically come down to is that part of the creditors' claims are converted into equity, thus providing the creditors with a stake in the company and therefore with the possibility to exert control over the company (while simultaneously watering down the interests of existing shareholders).

The scheme may also provide for an amendment of the rights of (i) guarantors and/or third parties against whom creditors of the debtor may exercise rights, and (ii) co-debtors against the debtor, and the rights of the creditors towards these parties. As a result, the restructuring of a group of companies may be completed by way of one scheme in The Netherlands; the scheme may not only focus on a "principal debtor", but also on the companies within the group that act as guarantor or that have provided security for the principal debtor. It will be interesting to see how cross-border structures

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4 That is, the concept of the debt for equity swap is now being codified. For many years, debt for equity swaps are being used in practice.

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will be dealt with (e.g. non-Dutch guarantors with Dutch law governed security documents) and this certainly needs to be crystallised in practice.

2.3 Classification of claims

The Draft Bill introduces the possibility under Dutch law to divide similar creditors into classes, according to the nature of their respective claims and interests. Where the scheme involves several classes of creditors and shareholders – i.e. creditors or shareholders whose claims or interests are so divergent that it cannot be said that, in bankruptcy, they could be treated the same – the scheme must provide for a class composition. In any event, where creditors or shareholders would rank differently in insolvency proceedings, they will have to be divided into separate classes.[5] For example, a scheme could provide for classes of (i) senior secured creditors, (ii) mezzanine-subordinated creditors and (iii) shareholders. It is evident that the rights and interests of these creditors will be different from each other and that their positions consequently differ. As with English Schemes of Arrangements, it is also possible to scheme only one class of creditors or shareholders instead scheming all creditors.

Classification of claims is considerably complex owing to a great range and variety of claims and to the statutory scheme of votes by classes as a prerequisite for confirmation. Hence, should any dispute arise with respect to classification, the Draft Bill allows that a debtor may request the court to render a decision on classification disputes.[6]

2.4 Treatment of executory contracts

Pursuant to the Draft Bill, the debtor who threatens to become insolvent, and for that reason wants to scheme his creditors and/or shareholders, has the possibility to restructure future commitments under existing (ongoing) agreements, in addition to his existing debts. These agreements may include, for instance, facilities agreements and/or intercreditor agreements but could also include a lease agreement for business premises or ongoing supply agreements. The Draft Bill offers the debtor the possibility to submit a proposal to the counterparty of an existing agreement to amend that agreement. If the counterparty declines the proposal, the debtor may unilaterally terminate the agreement, following court approval to do so and sanctioning the scheme. Aiming to terminate an agreement, notice should be sent to a debtor's counterparty in accordance with the agreed notice period, with a maximum of three months. This three-month period is in line with current Dutch bankruptcy law concerning the notice period to be observed for lease agreements during insolvency proceedings.

The provisions with respect to the amendment of ongoing agreements additionally provide for the fact that *ipso facto* clauses or change of control clauses, i.e. contract terms that automatically attach contractual consequences to initiating insolvency proceedings or other insolvency-related events in which the debtor is involved, remain without effect. Under Dutch law these are new instruments and the practice will need to get familiar with these tools to see what the scope is and what the effect and consequences will be of these new tools.

2.5 Temporary stay

After proposing a scheme to its creditors, the Draft Bill offers the debtor the possibility to request the court to order a temporary stay (*afkoelingsperiode*) for a period of four months maximum. A temporary stay preserves going-concern value by preventing creditors from taking enforcement actions against assets of the debtor. During this period, creditors can consequently only take recourse against the assets of the company after obtaining court approval to do so. When a debtor foresees that a temporary stay period of fourth months would be insufficient to finalise a scheme, the debtor can request the court to extent the stay period, making it possible to extent the stay period up to a maximum of eight months.[7]

The concept of a temporary stay is not something new under Dutch bankruptcy law, the Dutch Bankruptcy Act already provides for a stay period of two months following a bankruptcy or suspension of payments. This two-month stay period can subsequently be extended with another two months, making the temporary stay under a "Dutch scheme" significantly longer.

3. Voting procedures and confirmation of a scheme

Following negotiations between a debtor and its creditors, the debtor brings the scheme to a vote, whereby

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5 See also 11 U.S.C. § 1122(a) which states that 'a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class'.

6 A court can also, following a debtor's request, render a decision about, amongst others, the content of the information set out in the scheme or in the documents attached thereto and the right of a creditor or shareholder to vote.

7 As we understand, the Dutch legislator is, however, considering to introduce the possibility to extent this period up to a maximum of twelve months, which would align the Draft Bill with EC Directive 2016/0359/EU.

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the creditors whose rights are affected by the scheme (so-called impaired classes) have the right to vote. The scheme is accepted by a class of creditors if one or more creditors vote in favour of the scheme, which creditors must jointly represent at least two third of the relevant debt.

If at least one class of creditors votes in favour of a proposed scheme, the debtor can ask the court to confirm the scheme entitling it to enforcement, resulting in the possibility of a cross-class cram down. The starting point in a confirmation hearing is that the court will confirm a scheme except when one or more grounds for refusal are applicable.[8] General grounds for refusal are comparable with current practice under Dutch bankruptcy law and are of a formal nature, e.g. flawed voting procedures, a fraudulent scheme or other compelling reasons to refuse court confirmation. In any such case, the relevant court must refuse confirmation of the scheme ("the court shall refuse").

The Draft Bill also provides for more specific, or additional, refusing grounds, being, amongst others, the best-interests-of-creditors test (i.e. a "floor" with respect to the level of recovery to which creditors are entitled pursuant to any confirmed scheme. In other words, the company should be "worth more alive than dead") and a variation of the American absolute priority rule. In short, the absolute priority rule means that senior creditors are, in principle, entitled to have right to be paid in full before junior creditors receive anything. Furthermore, the situation where creditors who under the terms of a scheme do not have the right to opt for a payment in the form of cash in an amount equal to the amount that they could reasonably expect to receive upon a liquidation of the debtor's assets in bankruptcy could also lead to court refusal. A key feature of the Dutch version of the absolute priority rule is that deviating from the absolute priority rule will be possible if this is agreed between the relevant parties, e.g. by means of an intercreditor agreement or a subordination agreement. In case of the best-interests-of-creditors test, the court has to deny confirmation ("the court shall refuse") whereas in case of the Dutch absolute priority rule the court has more discretionary powers ("the court can refuse"). Notable is also that no appeal may be filed against a decision of the court with respect to a scheme.

4. Conclusion

Following prior formal consultation procedures and based on Directive 2016/0359/EU[9], the Draft Bill is now getting into a practicable and useable shape. The desire to restructure problematic debts in The Netherlands has grown over recent years and it has already lead to Dutch companies shifting their COMI's to e.g. the United Kingdom to set up Schemes of Arrangement or to file for Chapter 11. The impossibility to cram down secured creditors under current Dutch (bankruptcy) law has proven to be a clear obstacle in terms of effective restructurings. We believe that with this Draft Bill, Dutch practice will have a powerful instrument to restructure financially distressed companies, making The Netherlands more attractive to restructure not only domestic companies but also foreign companies.

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8 This approach defers from Chapter 11 where the starting point is that a court will only confirm a scheme if all conditions are met.

9 Directive 2016/0359/EU of the European Parliament and of the Council of 22 November 2016 on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

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