Dutch legislation on scheme of arrangement / Chapter 11 alternative accelerated due to COVID-19 - 11 questions answered

A brand-new pre-insolvency procedure for a compulsory composition will be introduced in the Netherlands shortly. The Dutch Act on the Confirmation of Private Plans (in Dutch: *Wet Homologatie Onderhands Akoord*, and in short: the **WHOA**) is expected to come into force on 1 July 2020. The corona-crisis has expedited the legislative process. The government designated the bill as urgent, requesting Parliament to handle the bill with priority with a view to entry into force on 1 July 2020. The new Dutch scheme complies with the EU Restructuring Directive (EU 2019/1023) and it is likely to be the first procedure which implements this Directive. Currently a Dutch restructuring outside of insolvency can only be accomplished on a completely consensual basis (i.e. every creditor can frustrate the process by exercising a holdout position).

The available Dutch options to successfully restructure financially distressed businesses are now about to improve substantially, which is good news in times where many businesses are experiencing financial distress as a result of the Corona pandemic. The Dutch scheme provides an instrument available to domestic and foreign debtors with business activities in the Netherlands through a compulsory composition outside of formal insolvency proceedings allowing them to quickly and efficiently restructure their debts (including those owing to secured creditors and shareholders). The scheme includes elements of a UK scheme of arrangement and the US Chapter 11, but also has some distinct features and costs are likely to be much lower than those of some of its foreign law counterparts. The easily accessible debtor-in-possession procedure can be a swift, final and effective one, with effective measures to guarantee deal certainty and protection of the restructuring scheme put in place, while creditors' rights are protected in a balanced way. The new Dutch scheme has been long awaited and has been well received amongst market parties (including financial institutions) and practitioners in the field.

The Dutch scheme may have a very material impact on your current financings and investments. This memorandum discusses its highlights and aims to answer the most important questions you may have.

Key points for businesses, investors and financiers to note:

- Easy to access debtor-in-possession procedure outside of insolvency with minimal court involvement
- Swift and efficient procedure: can be finalised within 5 weeks
- Content of the plan: maximum flexibility, can include debt-for-equity swap, haircuts, termination of onerous contracts, and changes to obligations of group companies
- The plan can be initiated by the debtor, or by creditors or equity through a court appointed restructuring expert
- The plan can bind all creditors (ordinary, preferred and secured) as well as equity
- A majority can bind a minority within each class (no head count) and the court can impose the plan on dissenting classes (cross-class cram-down)
- Absolute priority rule with reasonableness exception (see below under 7)
- Protection of the restructuring process: possibility to request a stay (partial or full), protection of security of DIP-financing, no ipso facto rights can be invoked, stay on requests for insolvency proceedings
- Deal certainty: specialized judges can take bespoke measures, render interim decision and the confirmation by the court is not subject to appeal
- Choice between public (covered by the Insolvency Regulation; COMI-based jurisdiction) and confidential (jurisdiction based on nexus with the Netherlands) proceedings

1. Under what circumstances and by whom can a restructuring plan be offered?

The WHOA applies to legal entities as well as natural persons acting in the context of their business or profession. If it can reasonably be assumed that the debtor will not be able to continue paying its debts as they fall due (the **WHOA Insolvency Test**), the debtor may propose a restructuring plan. This is a light test. For example, this test is met if a loan matures in 12 months from now and there is no prospect of repayment or refinancing. A creditor, shareholder or the work's council of a debtor (if it has one) may request the appointment of a restructuring expert to develop a restructuring plan. The court will appoint the expert if it believes this is in the best interest of the joint creditors. The debtor itself may request for the appointment of a restructuring expert but may also propose a plan itself as long as a restructuring expert has not been appointed. A restructuring expert only requires the debtor's consent to propose a plan if the debtor is a small or medium-sized enterprise (**SME**). The expert can go to court if the debtor refuses approval without substantiating valid reasons. Shareholders' approval to submit a restructuring plan is not required even if the debtor company's articles of association state otherwise. A limited exception applies to public limited companies. This means that shareholders cannot take a holdout position. The debtor has one shot only, and it is not eligible if it has offered an unsuccessful composition plan during past three years.

See 11 below with respect to the question as to when a WHOA scheme is also available to foreign debtors.

2. Which creditors can be affected by a composition plan? Does it extend to secured creditors?

The plan can bind all creditors (ordinary, preferred and secured) as well as equity. The debtor or expert is in principle also free to include or exclude certain groups or individual creditors/shareholders. However, parties cannot be excluded if this would lead to unfair treatment of certain creditors without a proper justification (see also 7 below). Excluded parties are not bound by the plan. Employees' rights cannot be amended.

3. What can be included the plan?

The Dutch scheme provides for a lot of flexibility: there is no prescribed form and no specific requirements apply with respect to the contents of a plan. A restructuring plan could for example include an amendment on or haircut with respect to (payment) obligations or new equity or a debt-for-equity swap (no shareholder approval required). Court confirmation constitutes the required corporate action. It could also include a unilateral amendment or termination of onerous contracts. If the restructuring offer is not accepted by the counterparty, the contract may be terminated, and the resulting claim for damages for breach of contract can be integrated in the plan.

4. Can a plan extend to other companies within a debtor's group?

Yes, if certain criteria are met. Changes to obligations of other group companies towards the debtor's creditors can be included in the restructuring plan if those companies also meet the WHOA Insolvency Test, it concerns rights and claims against the relevant group companies that (also) serve towards discharging a debt of the debtor, the relevant group companies agree to be included (or the plan is offered by a restructuring expert) and the Dutch court asked to approve the scheme would have jurisdiction if the relevant group company would offer a plan itself.

5. How does voting take place? Is a pledgee entitled to vote if it has voting rights over shares?

All creditors and shareholders whose rights are affected by the plan are entitled to vote (no exclusion of equity or related parties). If legal title is split from economic ownership on a claim, it will be the economic owner who has the rights to vote. If certificates have been issued, the certificate holder is entitled to vote instead of the shareholder. The explanatory notes to the bill do not go into the legal position of a party that has received a security interest over the relevant claims or shares. It is therefore advisable to include express provisions in any security document relating to claims or shares providing the secured creditor with WHOA voting rights (if applicable) on an event of default.

Creditors and shareholders who have dissimilar, incomparable rights must be placed in separate classes. Parties should be included in different classes if either: (i) they have a different rank or different rights in the event of liquidation in bankruptcy; or (ii) they receive different rights under the proposed plan. Creditors with same rank / rights in bankruptcy can therefore be in different classes and be offered different consideration under the plan. If a class of creditors is subdivided into more separate classes, differential treatment is only allowed if there is a reasonable justification for it. Voting can take place physically or electronically. The plan is voted on by each class. A class is considered to have approved the restructuring plan if two thirds (2/3) of the claims or equity (as applicable) that have voted in that class are in favour of it. There is no head count.

6. What is required for court confirmation? Is a cross-class cram-down possible?

The debtor, or appointed restructuring expert as the case may be, may request the court to confirm the restructuring plan if at least one class of creditors that is in the money (i.e. creditors whose claims would be expected to be at least partially satisfied in a liquidation of the debtor's assets in bankruptcy) approves the plan. A cross-class cram-down is therefore possible. Where one or more classes have rejected the plan (leading to a cross-class cram-down) the consent of the debtor is required in case the debtor is an SME (the shareholders in the SME may not procure the SME to withhold its approval on unreasonable grounds). After acceptance of the restructuring plan, it is binding upon all shareholders and creditors whose rights are affected by it.

7. What are the grounds for refusal?

Creditors and shareholders that voted against the plan can request the court to dismiss the restructuring plan (or the court can to so on its own initiative) on limited grounds provided in the WHOA, for instance: (i) the debtor does not meet the WHOA Insolvency Test; (ii) the plan or the appended documents do not contain all of the required information; (iii) the class formation or the voting procedure does not meet the WHOA requirements, unless the shortcomings could not reasonably have led to a different outcome of the vote; (iv) the debtor's performance of the plan (not the performance of instruments issued thereunder) is not sufficiently safeguarded; (v) the debtor wishes to obtain new financing to implement the plan and this will materially prejudice the interests of its creditors; (vi) approval of the plan was obtained on the basis of misrepresentation, by favouring one or more creditors or shareholders with voting rights above others or by other unfair means. Parties whose rights are not affected by the plan are not allowed to contest it.

Furthermore, if all classes voted in favour of the plan, the court can nonetheless refuse confirmation at the request of a dissenting creditor / shareholder if it summarily appears that such creditor under the plan is worse off than it would be in case of a liquidation in bankruptcy. This best interest of creditor test is based on the comparison of the expected distribution in event of liquidation in bankruptcy and the value of consideration receivable under the plan (i.e. including value of shares / debt instruments).

In addition, the court can refuse to confirm a plan that was not accepted by all classes, at the request of one or more creditors or shareholders who rejected the plan and who were placed in a class that did not accept the plan (i.e. a cross-class cram-down) if:

a. the distribution of the value realised with the plan deviates, to the disadvantage of the class that did not accept the plan, from the ranking that would apply upon enforcement against the debtor's assets, unless there are reasonable grounds for such deviation (e.g. payment of (certain) trade creditors in full to preserve going concern value) and the interests of the affected creditors or shareholders are not prejudiced by it; or

b. the plan does not give the relevant creditors a right to opt for a cash payment in an amount that is at least equal to the amount they would have received in cash in the case of a liquidation of the debtor's assets in bankruptcy.

No dissenting creditor may receive less value, whether in cash or in non-cash, than it would have received in a liquidation scenario. However, shareholders or lower ranking creditors cannot hold on to any value if higher ranking creditors are not paid in full. These supplementary grounds for refusal were largely inspired by two sections from the Chapter 11 procedure in the US: the 'best interest of creditors test' and the 'absolute priority rule' and provide an extra safeguard for classes of creditors who did not accept the plan with the required majority. Those creditors cannot be forced to continue to invest in the business of the debtor where they could otherwise have expected to receive a cash payment in the event of the debtor's bankruptcy. This can be particularly relevant for secured creditors, with a view to their expected recovery on secured assets in bankruptcy.

8. How are creditors' rights affected during the restructuring process and is going concern protected?

The Dutch scheme includes a number of measures that serve to protect the restructuring process. Main points include:

- Stay on enforcement: The debtor, after filing the restructuring declaration or undertaking to submit a plan within two months, or the restructuring expert (if appointed), may request the court for a (partial or full) stay of enforcement by creditors, even those not affected by the plan. This prevents any - including secured - creditors from seeking recourse through collection and enforcement measures, such as levying an attachment or enforcing security on assets of the debtor, other than with prior court approval. A secured creditor may not notify third parties of its right of pledge over receivables during the stay as long as adequate substitute security is provided (which could also consist of new receivables that become subject to the right of pledge). The duration is of a stay four months initially, with a possible extension to a maximum of eight months (is significant progress was made on the plan). A stay can also extend to group companies.

- Stay on requests for insolvency proceedings: Once the debtor has filed the restructuring declaration, any requests for the opening of insolvency proceedings (bankruptcy or suspension of payments) are suspended for a period of four months (with a possible extension to a maximum of eight months).

- Debtor-in-possession: Continued authority of debtor to use, consume and dispose of encumbered assets in the ordinary course of business. The debtor-in-possession procedure allows the debtor to remain in full control of the ordinary business throughout the procedure. The restructuring expert, if appointed, is only involved in the development, negotiations and filing of the plan. However, if the assets in question are subject to security rights (or other rights), the relevant security creditor must be provided with adequate substitute security.

- No ipso facto rights: Contractual provisions allowing the debtor's counterparty to amend, suspend or terminate a contract with the debtor in the event of a restructuring procedure cannot be invoked or triggered whilst parties are working on the plan. The same applies to change of control provisions. This means that the scheme preparations cannot lead to an event of default (or at least that it cannot be invoked). Furthermore, a default that occurred prior to a stay, does not give the right to terminate or suspend performance during the stay (subject to adequate protection for the creditor).

- New funding and protection of security: Restructuring efforts are protected from annulment on the basis of fraudulent preference. Court approval is required, but consent will usually be granted as long as the relevant act serves the interest of the joint creditors and it is not detrimental to the rights of just one creditor. Amongst other things, this protects DIP-financing as well as the granting of security by the debtor in relation thereto. A set-off that takes place in the context of such new financing is in principle also protected. There is no super priority DIP-financing.

- You snooze, you lose: A creditor or shareholder that fails to protest on the basis of a possible ground for rejection within a reasonable time after it discovers or should reasonably have discovered the relevant circumstances, loses the right to oppose to invoke relevant ground for rejection. A timely protest enables parties to find a solution or request court for intermediate decision before the vote.

9. How can the proceedings be influenced and how is deal certainty enhanced?

- Binding interim decisions: During the procedure, the debtor or the restructuring expect (if appointed) can request the court to take final decisions on difficult issues at an early stage, removing uncertainty before the vote. Decisions can be rendered on, for instance, the (outcome of the) pre-insolvency test; the information that needs to be provided to affected parties in order to allow them to make an informed decision; eligibility to vote; the voting procedure; class formation; whether there is a ground for refusal of the court confirmation of the proposed plan.

- Bespoke measures, such as the appointment of an observer: Furthermore, at the request of the debtor or at its own initiative the court can make such determinations or provisions as it deems necessary to safeguard the interests of the creditors or shareholders (e.g. the appointment of an observer – a different person than the restructuring expert – to monitor the process of the Dutch scheme with due regard to the interests of the joint creditors).

10. What do the proceedings look like and how long will the restructuring process take?

The proceedings start by the filling of declaration with court by debtor or appointment by court of restructuring expert. Although no set timeframe applies, the procedure can be quick: a final decision on the Dutch scheme to be applied can be reached as fast as within 5 weeks. Voting may take place 8 days (or more) after the restructuring plan has been proposed to the affected parties. A voting report must be presented within 7 days after the vote. If the restructuring plan is approved, the court will hear the request for confirmation of the plan within 14 days. The court will then decide on the matter as soon as practicably possible. As the court's decision is not open to appeal, the procedure provides for a quick turnaround. Practically, it is expected that a debtor will ensure that the proceedings will not take longer than the stay (4 + 4 months). Specialised judges render final decisions, which are not subject to appeal.

11. Can you choose between a public and a confidential version and why opt for one or the other?

Yes, the WHOA provides for public proceedings, recognised under the European Insolvency Regulation (**EIR**), and an undisclosed non-EIR alternative. In accordance with the EIR, the Dutch courts will have jurisdiction in public WHOA proceedings if the debtor has its centre of main interests (**COMI**) in the Netherlands. A public plan benefits from automatic recognition in all EU member states (excluding Denmark), although the EIR includes some limitations. The public proceedings are published in the Central Insolvency Register.

The non-EIR undisclosed proceedings are confidential. The debtor need not have its COMI in the Netherlands. The Dutch court assumes jurisdiction if the debtor and/or a party affected by the plan is situated in the Netherlands. In addition, jurisdiction is assumed if there is a sufficient connection with the Netherlands. This link is very broad, which means that the non-EIR version can also be available to debtors that do not have their COMI in the Netherlands, as long as there is a sufficient connection with the Netherlands. Examples of such a link are: the debtor having (significant) activities or assets in the Netherlands, a (substantial) portion of the debt subject to the plan is subject to Dutch law or a Dutch court choice of forum, the debtor is part of a group companies some of which are situated in the Netherlands. Given this broad range and like the English scheme of arrangement, it is expected that the non-EIR version of the Dutch scheme will, in particular, be a useful tool for cross-border restructurings (without the limitations that apply under the EIR). Although the non-EIR version does not benefit from automatic recognition in other countries, decisions are nevertheless expected to be widely recognised through treaties in place between the Netherlands and other jurisdictions and through national rules of private international law.

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