From : Windt Le Grand Leeuwenburgh
Subject : Dutch Scheme (WHOA) update by Q&A and notes on five leading cases
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MEMO

INTRODUCTION

On 1 January 2021, the Dutch Scheme Act (WHOA) came into effect. Now, more than two and a half years later, is a good time to assess how this has played out so far. We will do so by means of a Q&A and by discussing five leading cases (see below) two of which we have been involved in.

The cases highlight the flexibility of the WHOA and how quickly courts render sanction orders, often within three weeks of filing, especially when the proposed plan has strong support from creditors. Conversely, courts closely review only marginally supported plans. And the Vroon and Diebold Nixdorf cases demonstrate the WHOA's ability to handle complex international restructurings, involving both UK and US proceedings along with Dutch WHOA proceedings.

The five cases we are highlighting are:

- **Fit For Free (now named SportCity):** In this case the debtor managed to secure a payment holiday and amendments to fully drawn credit facilities (a covenant holiday and a covenant reset), despite facing strong opposition from lenders. These measures facilitated a recovery from COVID-19 lockdowns related losses.
- **IHC:** This case involved a scheme that enabled a liquidity event – the sale of a profitable, subsidiary whose shares were pledged – despite opposition from secured lenders. Also, non-consenting lenders were forced to maintain credit lines.
- **Steinhoff:** This publicly listed retail conglomerate effectively side-stepped its out-of-the-money shareholders and established a non-listed, stable platform to wind down the group.
- **Vroon:** A shipping company's strategic use of both an English Scheme and a public Dutch Scheme resulted in the division of its over-indebted group into a profitable fleet and a non-core fleet prepared for gradual liquidation. The use of the English Scheme overcame the 'Rule in Gibbs,' which typically hinders the full recognition of foreign schemes under English law.
- **Diebold Nixdorf:** A NYSE-listed ATM manufacturer combined a US Chapter 11 process with a Dutch Scheme. Notably, the Dutch scheme was recognised by a US bankruptcy court in a Chapter 15 process.

The Q&A will now first guide you through some key features of the Dutch Scheme, including the moratorium. We will focus on the effects for lenders and shareholders since most large cases, including the five we cover, are financial restructurings that do not affect operational creditors.

The Q&A and case notes can be read separately. The Q&A covers essential topics and illustrates these by reference to the cases. The case section offers more detailed insights into the cases. You can read either section or both.

GENERAL

What are Dutch Scheme proceedings?

In WHOA proceedings debtors can request a court to confirm a scheme (a restructuring plan). Once confirmed the scheme may impair rights of shareholders and creditors without their consent. Rights against guarantors may also be affected. The court may allow unilateral contract termination (comparable to the US Chapter 11 rejection of an executory contract) against compensation. The resulting claim for compensation (damages) may be impaired (included in the scheme) too.

There are two types of Dutch Scheme proceedings: undisclosed and public. Other than the principal difference in terms of the proceedings being public or not, the two types differ in that public proceedings are recognised automatically in the EU (except Denmark) if the debtor's centre of main interest (COMI) is in the Netherlands or if the debtor has an establishment in the Netherlands (secondary proceedings).

How does the Dutch Scheme compare to other restructuring regimes?

The WHOA is comparable to the UK Restructuring Plan, the English Scheme of Arrangement and US Chapter 11. It implements the EU Restructuring Directive, and so shares a common basis with other EU member state scheme proceedings doing so, like the German StaRUG.

Dutch Scheme proceedings have been combined with an English Scheme of Arrangement (Vroon) and recognised under Chapter 15 of the US Bankruptcy Code (Diebold Nixdorf), implementing the UNCITRAL Model Law on Cross-Border Insolvency. The Steinhoff restructuring also involved creditors and shareholders in multiple jurisdictions. These cases demonstrate the WHOA lives up to the expectations of being a cross-border restructuring tool.

When do Dutch courts have jurisdiction and what is the scope?

Dutch courts have jurisdiction if the debtor's COMI is in the Netherlands or in case of sufficient nexus to the Netherlands. The EU Insolvency Regulation applies to public proceedings if (leaving secondary proceedings aside) the debtor's COMI is in the Netherlands in which case, as noted, the proceedings and the scheme's effects are in principle automatically recognised in the EU (except Denmark).

The scope of a scheme confirmation judgment (sanction order) is universal under Dutch law, i.e., under Dutch law it affects debt regardless of the law applicable to the debt. But a confirmation order issued by a Dutch court may not always be recognised under foreign law, e.g., in the UK under the Rule in Gibbs. In the Vroon case this was the reason to combine Dutch Scheme proceedings with an English Scheme of Arrangement.

MORATORIUM IN THE DUTCH SCHEME

How are credit agreements and security rights affected by a moratorium?

Limitations on drawstops and acceleration. A lender may not refuse to fund a requested drawdown (drawstop) or demand early repayment of the loans (acceleration) based on so-called *ipso facto* provisions, i.e., provisions triggered by the scheme proceedings themselves, their preparation, or the implementation of the scheme. This also applies outside a moratorium. If the Court declares a moratorium (there is not an automatic stay) a drawstop or acceleration on account of defaults (or events of default) that have occurred prior to the moratorium is also barred if the debtor provides sufficient security for new obligations (e.g., repayment of new loans drawn and interest on such utilisations).

Limitations on enforcement. If secured debt is subject to the moratorium, security rights may in principle not be enforced and the pledged property may be used to keep on running the business provided the pledgor provides sufficient replacement collateral. If the business of the pledgor continues, replacement collateral may arise automatically in the form of new pledged receivables (working capital cycle).

Does the moratorium provide a payment holiday?

Yes, effectively it will. We distinguish between old debt and new debt. Old debt is actively incurred before the relevant moment (e.g., filing of a moratorium request), for example a loan drawn before the request but also interest on that loan, even if accruing after the request. New debt is actively incurred after the relevant moment (e.g., the filing of a moratorium request), for example a loan drawn after the filing and interest accruing on that loan. A moratorium may, depending on the scope (the court may vary the scope) in fact provide a payment holiday in the sense that the court will not expect the debtor to pay old debt and that creditors have no means of enforcing their claims.

How is interest on debt treated?

It appears that the time the interest bearing debt has arisen is relevant (and of course whether that debt has been included in the moratorium by the court). If the principal amount is new debt, e.g., a loan drawn after the ‘cut-off date’ (the date on which then existing debt will be included in the scheme) or after the filing of the moratorium request, we expect courts will require interest to be paid as running cost. If the principal amount is old debt, e.g., a loan drawn before the moratorium request was filed, the position is not clear yet and debated. Court cases do not provide clarity on this point either. In the Fit For Free case no interest appears to have been paid during the moratorium on senior debt affected by the scheme, as opposed to interest on affected super senior debt which appears to have been paid. Interest on senior debt was compounded under the scheme.

How long does a moratorium last?

The court may grant a first term of no more than four months and extend the term in principle, allowing for repeated extensions up to a total of eight months.

Is there also other protection available, outside a moratorium?

Yes, the debtor may request that the court grants an injunction, e.g. barring the shareholder from dismissing or suspending board members, like the court did in the Vroon proceedings.

EFFECTS OF A SANCTIONED SCHEME

How can security rights and secured debt be impaired by a scheme?

The ranking of rights of pledge and rights of mortgage cannot be affected. As a result, priming for debtor-in-possession (DIP) financing is not possible (i.e., where a new lender financing the scheme proceedings takes priority over existing lenders that do not). In contrast, waterfall provisions in an intercreditor agreement can in principle be amended through implementation of a scheme (as seen in the discussed IHC case below) since this is deemed to be a matter of contract.

Secured debt may be affected by a scheme. Bank debt and unpaid interest are treated as any other debt subject to the cash-out exception (as detailed in the subsequent section). Debts may be restructured by deferral of payment obligations, a covenant reset (see the Fit For Free case below), full or partial release of claims for no consideration or conversion into equity.

To the extent that in bankruptcy a distribution would be made on debt included in the scheme, the debtor will need to offer a cash-out option at liquidation value, i.e., the distribution that would have been made to a specific (group of) creditor(s) in bankruptcy proceedings. This means the creditor should be given the option to choose to receive a cash amount which is not less than what he would expect to receive in bankruptcy. There are two exceptions to this rule. One is where his class accepts the scheme, the other exception applies to professional finance parties (like banks) provided their claim is secured by a pledge or mortgage. However, they cannot be compelled to accept shares or depositary receipts for shares.

Regarding drawn commitments under a secured syndicated facility agreement (SFA), such as the Fit For Free case discussed below, these may be restructured into an amended SFA. In that case, the cash-out exception enabled the debt to be rolled over with a covenant holiday and covenant reset because the non-consenting lenders could not force payment of the liquidation value.

How are commitments treated in a scheme?

Until the IHC case (see below), it was generally assumed that the conditions governing available commitments could not be amended without the consent of the lender affected. The assumption was, as with other agreements, that the credit agreement could be terminated, even against the will of the lender, with court permission and against compensation, but that the credit agreement (as opposed to any debt outstanding thereunder and the terms of such debt) could not be amended against the lender’s will.

Since the IHC case, it seems that the conditions governing available commitments can be amended, or at least overruled, without the consent of the lender affected. In IHC the lenders that did not vote in favour of the scheme – which involved ‘all lenders’ consent’ matters – were overruled by the two-third majority vote of their class. The scheme, among other things, continued the availability of credit lines and included the sale of a material subsidiary, whose shares were pledged to the lenders, also for the benefit of the non-consenting lenders. Despite their objections, the court approved the scheme. The outcome was that the non-consenting lenders were forced to maintain the credit lines (available commitment) even though the credit protection had been amended against their will and in spite of contractual voting requirements.

How are shareholders treated in a scheme?

Typically, shareholders will have no share in the reorganisation value (i.e., the value of the company assuming the restructuring plan has been implemented) and stand to lose their entire holding. However, if they share in the reorganisation value, they should be allocated the corresponding value. This may be a substantially diluted position (like in Vroon) but in exceptional cases shareholders may be left unaffected. This may occur (i) if the value breaks in the equity (see Fit For Free, where the company merely needed more time to pay its debts and could afford to compensate the lenders for the delay) or (ii) if the relevant creditor classes agree the shareholders are excluded (like in IHC) or do not request that the court reject sanction for that reason (like in Diebold Nixdorf, in respect of the Dutch company).

CASES

As mentioned in the introduction, we will now discuss five cases that demonstrate potential consequences of Dutch Scheme proceedings for lenders and shareholders:

- **Fit For Free:** a forced payment holiday, and covenant holiday and covenant reset,
- **IHC:** the shipyard that forced a liquidity event by selling a pledged subsidiary,
- **Steinhoff:** the listed retailer that created a delisted, stable liquidation platform,
- **Vroon:** the shipping company that combined the English and Dutch Scheme and
- **Diebold Nixdorf:** the ATM maker that combined US Chapter 11 with the WHOA.

Fit For Free

Fit For Free (now named SportCity) is a national chain of gyms that was materially affected by the COVID-19 lockdowns. Customers were no longer able to go to the gym and EBITDA quickly fell below the covenant levels of a syndicated facility agreement of which all commitments were utilised, meaning that all loans were fully drawn (this distinguishes Fit For Free from IHC, which we discuss below). After a first round of forbearance from the financiers (funds) and a cash injection from the sponsor to mitigate the impact of the first lockdown, another round of forbearance and a further cash injection was required due to a second lockdown period.

However, this time the funds did not accept the proposed restructuring. Instead, they announced to exercise the voting rights on the pledged shares in the holding company. By doing so, the lenders intended to replace the directors, presumably with the intention to subsequently enforce the share pledge by selling the shares, potentially through the implementation of a credit bid. Rumour has it the syndicate lenders were pursuing a “loan to own”-strategy.

The debtor countered by requesting that the court declare a moratorium under the Dutch Scheme, freezing the announced enforcement measures. The court considered voting on pledged shares, as was announced by the lenders, an enforcement step and granted the request. Approximately ten months and a valuation dispute later, with valuations ranging from € 90 million to € 300 million, the court confirmed a scheme (including fresh money from the sponsor) which forced the lenders to accept a covenant holiday and PIK provisions affording the debtor time to recover after the lockdowns. The lenders voted against the scheme, however the tax authority was in the money due to its preferential claim and voted in favour of the scheme on a tax claim constituting around 3% of the total debt affected by the scheme. This was sufficient for the court to sanction the cram-down request. From the court decisions, it appears that the debtor was not required to make interest payments during the moratorium.

Takeaways

- A syndicated facility agreement (SFA) of which all commitments are utilised (fully drawn) can be amended by a scheme forcing these amendments on the lenders. Covenant testing may be paused, and financial ratio’s may be reset to provide room for recovery.

- Shareholders can remain unaffected (note that they did inject cash) if (i) the reorganisation value breaks in the equity and (ii) the amended SFA does not reduce the aggregate principal amount outstanding and includes a market standard interest rate.

IHC

IHC is a shipyard that foresaw it could not timely repay a loan which would be an event of default under its syndicated facility agreement (SFA). Other than in the Fit For Free case, the shipyard's SFA still had available commitments (the facilities were not fully drawn). IHC's sponsor was willing to buy the shares of a profitable subsidiary of the shipyard so IHC could use the proceeds of the sale to deleverage and as liquidity. However, the shares were pledged to the lenders, and the sale (or the way the divestment proceeds were applied) required all lenders' consent, as did other amendments proposed by IHC to restructure both the SFA and the intercreditor agreement (ICA). Three out of nine lenders, at least one of whom had been involved in the shipyard's previous restructurings, did not support the plan and the court granted a moratorium requested by IHC to prepare a scheme to force the plan on the non-consenting lenders. (The non-consenting lenders were a Dutch bank and two English banks. The SFA was governed by Dutch law.)

Within three months, the court indeed confirmed a scheme that forced the non-consenting lenders to accept the amendments. The court rejected the argument that the scheme in fact imposes amendments to the finance documents, cutting through 'all lenders' consent' matters. The court considered this acceptable under the circumstances because the financing conditions would not be materially amended (commitments were effectively reduced) and because the court considered the amendments in line with the statutory provision enabling the amendment of creditor rights under the WHOA. In addition, the court considered that the scheme does not impose new obligations. The scheme would cure an event of default, enabling the company to use the facilities again (i.e., an existing obligation for the lenders to fund). The imposed amendments are not of such nature that they affect the conditions under which the commitments may be used in the future, according to the court. It also considered that a different view on this matter would make the envisaged restructuring meaningless.

This judgment has been critically received because the WHOA does not grant courts the authority to amend contracts, whereas this judgment can be seen doing exactly that.

Takeaways

- A syndicated facility agreement which is not fully drawn can be amended by a Dutch Scheme that can be forced on non-consenting lenders, even in relation to undrawn commitments. This way, with sufficient lender support, the debtor can cut through all lenders' consent matters despite non-consenting lenders and force non-consenting lenders to continue to provide financing.
- Important circumstances of the case appear to have been that outstanding debt and commitments were reduced, and that there was broad support from relevant creditors (all classes voted for the plan; cram-in, in contrast to cram-down).

Vroon

Vroon is a Dutch shipping company, that owned or operated a fleet of approximately 100 sea-going vessels, financed by various banks with a corporate guarantee from Vroon, including under English law. Part of the fleet was struggling (the offshore ships especially).

The scheme enabled the rightsizing of bank debt and the division of the group into two parts. One part (NewCo) is intended to continue as a going concern and the other part (ExitCo, for the non-core business) will be wound down gradually by selling the ships. The shareholder's stake was substantially diluted to 4.91% and creditor classes were issued the remaining equity. Bank debt in the ExitCo becomes limited recourse which creates a stable platform to sell the ships. The disclosed proceedings were combined with an English Scheme to enable minority non-consenting lenders to be bound as well. This was required because the binding effect of a Dutch Scheme against non-consenting creditors is not recognised under English law in relation to English law governed debt, the 'Rule in Gibbs' that has become more relevant again since Brexit.

During the preparations Vroon also obtained an injunction against its shareholder – which objected to the scheme – to prevent the shareholder from suspending or dismissing the chairman of the supervisory board or members of the managing board. The court considered that the managing board is in the lead during Dutch Scheme proceedings and not the shareholder. The court did appoint an observer to keep an eye on the tensed process in the interest of all affected parties (including the shareholder) and, to point out that the shareholder was not left empty-handed, considered the shareholder could request to appoint a restructuring expert.

Takeaways

- The disclosed Dutch Scheme proceedings can be used in combination with English Scheme proceedings and can combine a controlled winding up with a restructuring.
- The WHOA provides means to protect the board against the shareholder if the court finds the shareholder threatens the interests of the joint creditors.

Steinhoff

Steinhoff is a retail conglomerate listed in Johannesburg and Frankfurt, plagued by financial difficulties which stem from a bookkeeping scandal which was uncovered in 2017, from which it never recovered, despite settling class actions. The Steinhoff group is financed by various banks on a subsidiary level backed by a form of guarantee (referred to as a conditional payment undertaking) provided by the Dutch holding company. The banks were not prepared to extend the maturity date unless a scheme would be sanctioned that effectively enabled the substitution of the publicly listed holding company with a private entity. The plan provides Steinhoff a stable platform to liquidate its assets and allocates contingent value rights (CVRs) to the lenders, entitling them to 80% of any liquidation surplus with the remaining 20% being allocated to the shareholders who have been disenfranchised. All classes practically unanimously accepted the scheme except for the shareholders. A German shareholders association requested the court of Amsterdam to refuse sanction.

Takeaway

- The WHOA can also serve as a viable option for a liquidation plan enabling a delisting and controlled solvent winding-up.

Diebold Nixdorf

Diebold Nixdorf, an NYSE-listed, overindebted ATM maker, combined Dutch Scheme and US Chapter 11 proceedings in the Southern District of Texas. The Dutch sanction order and Dutch Scheme held full force in the US. All classes, except unsecured noteholders, accepted the scheme, most with over 95% support.

Takeaway

- A Dutch Scheme proceeding has been recognised as a foreign main proceeding by a US court under Chapter 15 of the US Bankruptcy Code which is based on the UNCITRAL Model Law on Cross-Border Insolvency. This, along with the Vroon case, showcases the WHOA's strong cross-border restructuring potential.

More information is available at: www.windtlegal.com > News > WHOA

Should you have any questions please feel free to contact one of our restructuring experts:

Ruben Leeuwenburgh
Partner

+31 6 4355 0980
r.leeuwenburgh@windtlegal.com

Michiel Bindels
Partner

+31 6 1320 6960
m.bindels@windtlegal.com

Marcel Windt
Partner

+31 6 5365 4222
m.windt@windtlegal.com

Mark Mouthaan
Counsel

+31 6 8274 1694
m.mouthaan@windtlegal.com

We are happy to share our views!