



Dutch Court Approval of a Private Composition (Prevention of Insolvency) Act

1. Introduction

The Dutch legislator is currently debating on a legislative proposal which will make it possible to restructure companies by means of a private agreement outside formal insolvency proceedings (the Court Approval of a Private Composition (Prevention of Insolvency) Act (*Wet homologatie onderhands akkoord*) or “*WHOA*”).

Inspired by the English *Scheme of Arrangement* and the American *Chapter 11* procedure the WHOA will provide a versatile and highly effective restructuring mechanism, in particular through the possibility to bind groups of reluctant creditors to the composition under specific circumstances. Such possibility currently only exists within the framework of formal insolvency proceedings. Save for very exceptional cases, at this point only fully consensual restructuring is possible on a going-concern basis.

The WHOA further provides a broad basis for jurisdiction of the Dutch courts and flexibility in the scope, preparation and elaboration of the composition, furthering effectiveness even more. Entry into force is expected this fall.

2. Main aspects

- **Purpose** – A composition based on the WHOA can aim either to prevent an impending liquidation of a company that would be financially sound again after debt restructuring and to wind up a company other than through bankruptcy if it no longer has any chance of survival.
- **Availability** – The WHOA is available to debtors conducting a business, regardless of their legal form. To be eligible for the WHOA, the debtor must be in a situation where it is reasonably likely that he will not be able to continue to pay his debts (the pre-insolvency situation). This means a situation in which there is no realistic prospect of avoiding future insolvency if its debt is not restructured. The debtor itself but also one or more of its creditors, shareholders, its works council or employee representatives may initiate the WHOA in that situation. Important to note is that no prior court decision is necessary. However, the court may be called upon to settle any uncertainties or points of discussion at an early stage in order to provide more clarity down the line and increase the chances of success.
- **Public or private** – The WHOA can be initiated both *publicly*, in which case the fact that a debtor wishes to make use of the WHOA is stated in the central insolvency register (*Centraal Insolventieregister*), and *privately*, in which case only the parties involved in the composition are notified of the (intended) application of the WHOA.
- **Restructuring expert** – If a party other than the debtor initiates the WHOA, that party must submit a request with the court for the appointment of a restructuring expert. The restructuring expert may offer a composition on behalf of the debtor. The debtor itself is also entitled to request the court to appoint a restructuring expert. Such request will be granted by the court if the debtor is in a pre-insolvency situation, unless it summarily establishes the appointment of a restructuring expert does not serve the interests of the creditors.
- **Composition** – The debtor or the restructuring expert is authorised to offer a composition to creditors and shareholders. The composition may relate to the position of unsecured creditors, creditors with security rights (secured creditors), preferential creditors and shareholders. The composition does not have to be collective; (groups of) creditors and/or shareholders may be disregarded in the composition.
- **Offering** – If no restructuring expert is appointed, the debtor is authorised to offer a composition. In case a restructuring expert is appointed, the restructuring expert is exclusively authorised to do so. The debtor may then propose an intended composition to the restructuring expert and request to submit it to the creditors and shareholders. In case of an SME and if the restructuring expert is appointed upon request of a creditor or the works council or employee representatives, the restructuring expert requires the debtor's consent to offer a composition. The restructuring expert may appeal to the court for substitutional approval if the debtor refuses to approve.
- **Voting** – The composition is only put to a vote to the creditors and shareholders whose rights are intended to be amended by it. Creditors and shareholders can be classified in different categories; voting takes place by category.
- **Authority to dispose** – Under the WHOA the debtor remains authorised to dispose of its assets (*debtor in possession*).
- **Cooling-off period** – The debtor or restructuring expert may request a cooling-off period of up to four months with the possibility of extension to an aggregate maximum of eight months.
- **Broad basis for jurisdiction and group restructurings** – Depending on the conditions Dutch courts may approve compositions for both Dutch and foreign debtors, allowing cross-border restructurings to be implemented from The Netherlands.

3. The composition

When designing a composition, freedom of contract is assumed as a basic principle, causing the WHOA to offer a wide range of possibilities to reorganise the capital structure of the debtor, e.g. by payment in instalments and debt cancellation or conversion into equity (*debt-for-equity-swap*). Also, not all creditors need to be involved in the composition. The composition can for instance be directed at 'financial' creditors or trade creditors or exclude a specific group of creditors. In addition, it is possible to propose the amendment of an onerous contract. Should the contractual counterparty not agree to such proposal, the contract may be terminated as part of the composition and the claim for compensation resulting from the unilateral termination may then be included in the composition. Employment contracts are an exception, to the understanding that the WHOA does not cater for the possibility to affect or amend employee rights ensuing from employment contracts.

In each case the starting point is that the composition qualifies as *reasonable*. This generally means that the composition needs to be beneficial or at least not detrimental to all creditors and shareholders involved. More specifically, this means:

- a) the composition may not lead to a significantly worse position for the creditors and shareholders involved than would have existed in case of bankruptcy;
- b) the value retained or realised with the composition (the reorganisation value) must be distributed fairly among the creditors and shareholders, to the understanding that the (statutory or contractual) priority ranking must be respected, unless one or more relevant categories of creditors agree differently; and
- c) creditors – other than 'financial' creditors holding security interests – which in bankruptcy may be expected to receive payment in cash and have voted against the composition by a majority of their category, should have the right to opt for a payment in cash equal to the amount that would have been received in bankruptcy (the liquidation value).

4. Voting

To submit the composition for court approval (*homologatie*) it must be put to a vote. The creditors and shareholders whose rights will be affected by the composition are entitled to vote. To enable them to vote, the composition must be submitted to the creditors and shareholders with voting rights at least eight days prior to voting. Voting can take place during a physical meeting or meeting by electronic means of communication as well as in writing (e.g. by email).

The creditors and shareholders with voting rights are classified in separate categories if their expected rights in bankruptcy or under the composition differ in a way that their positions are incomparable. Voting on the composition is done by class. Creditors with pledge or mortgage priority are assigned to one or more categories of creditors with such priority, but only in respect of the secured part of their claim. The value of the portion of their claim subject to priority is estimated based on the value expected in bankruptcy. The excess of their claim is treated as unsecured and will run along in the category of unsecured claims. There should be a separate category for small creditors if the composition offers them less than 20 per cent. of their claim. Such offer of less than 20 per cent. is only permitted if compelling grounds so justify. A class has voted in favour of the composition if a minimum of two-thirds of the creditors and shareholders jointly representing at least two-thirds of the total amount of claims or issued capital has voted in favour, to be determined by the amount of their claims or the nominal value of the shares involved.

If at least one class of creditors which – in short – is expected to be paid in full or in part in bankruptcy has agreed to the composition, the debtor or the restructuring expert may submit the composition to the court for approval.

5. Sanctioning and cross class cram down

Sanctioning of the composition (*homologatie*) in principle requires all creditor categories to vote in favour. However, under certain circumstances the court may still approve the composition even if one or more creditor categories have voted against. Such *cross class cram down* may exist if – briefly put – one creditor category which is expected to have received a distribution of some sort in bankruptcy has voted in favour.

The court may reject a request for approval upon request of one or more creditors or shareholders with voting rights which have opposed to the composition if it summarily appears the composition will place them in a worse position than bankruptcy (*creditors' best interest*). The court furthermore rejects a request for approval upon request of one or more holders of voting rights that have opposed to the composition and are classified in creditor categories that have opposed, if:

- a) the class of small creditors will receive a distribution of less than 20% of their claim, unless compelling reasons so justify;
- b) the distribution of value retained or realised by the composition (the reorganisation value) deviates from the statutory or contractual order of priority to the detriment of an opposing class, unless there are reasonable grounds for such deviation and the requesting creditors' or shareholders' interests are not affected as a result;
- c) the creditors (other than creditors referred to under d below) are not entitled under the composition to opt for payment in cash equal to the amount they would have received in bankruptcy (the liquidation value);
- d) the composition offers shares or depositary receipts to secured creditors that have funded the debtor on a commercial basis without the possibility to opt for a distribution in any other form.

Finally, there are various grounds for rejection of an approval request the court is required to examine *ex officio*. These grounds include a failure to meet procedural requirements, a failure to sufficiently guarantee performance of the composition or the fact that the composition was made based on fraud or unfair means.

The hearing for the approval of the composition takes place within eight to fourteen days after the date of the request. The court will then decide on the request as soon as possible. It is envisaged that the process as from the submission to the creditors and shareholders up to sanctioning of the composition will last four to six weeks.

6. Supportive measures

The WHOA provides for the possibility to request various measures to support the process of reaching a feasible composition as well as to address uncertainties regarding the validity of the composition in advance. The debtor or the restructuring expert may e.g. request the court to rule on certain aspects of the composition in advance such as the assessment of relevant values, classification and voting procedure. With the approval of the court the debtor may furthermore terminate onerous contracts and enter into funding arrangements necessary to continue the company during the preparation of the composition without any risk of annulment or claw-back.

The WHOA provides for supportive measures of a different kind as well. *Ipso facto* stipulations in contracts (e.g. a stipulation ending an agreement automatically if a particular event occurs) relating to the preparation and offering of a composition based on the WHOA or acts relating to or reasonably necessary for the preparation of a composition under the WHOA will be ineffective by operation of law. This also applies to provisions that impede performance of the composition such as change of control stipulations or approval requirements in the company's articles or a shareholders' agreement.

The Dutch courts will furthermore instate a pool of judges designated to handle requests under or relating to the WHOA. Their judgements are not subject to appeal.

7. International jurisdiction, recognition and group restructurings

In terms of jurisdiction and recognition in an international context it is relevant whether the WHOA procedure is initiated publicly or privately. The public procedure is governed by the European Insolvency Regulation (EIR) with Dutch courts having jurisdiction in case the centre of main interests of the debtor is located in The Netherlands. Recognition of the procedure and the approved composition will occur automatically in all EU Member States (other than Denmark).

If the procedure is initiated privately, there are still grounds for the Dutch court to have jurisdiction; even if the debtor's centre of main interests is not located in The Netherlands. Jurisdiction may be assumed if (one of) the applicants or one of the stakeholders included in the request is domiciled or habitually resident in The Netherlands or if the matter is otherwise sufficiently linked to the Dutch jurisdiction. The latter can be the case if e.g. the debtor has its centre of main interests, an establishment or (substantial) interests in The Netherlands, a substantial part of its debts follows from Dutch law governed obligations or is subject to a choice of forum for the Dutch courts, a (substantial) part of the debtor's group companies is based in The Netherlands or the debtor is jointly liable for the debts of a third party over whom the Dutch courts have jurisdiction.

The last two grounds will especially provide for ample scope for Dutch jurisdiction in case of international groups that require debt restructuring. The international recognition of the private procedure and any approved composition arising out of it is dependent on international private law rules of the jurisdiction where recognition is sought. However, it is expected that recognition will be possible under the UNCITRAL Model Law in jurisdictions that do not require reciprocity in that respect.

More information is available at: www.windtlegal.com

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



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