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European Update

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The Dutch "Chapter 11"

A Game-Changer for Restructurings in Europe?

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Editor's Note: *In Europe, the restructuring community has been waiting for a number of years for the Dutch legislator to put forth its proposals to introduce the Dutch "chapter 11." We are now almost there and the legislation has been published; it is awaiting final adoption by parliament. The proposal needs to be considered and approved by both the Lower House and Senate in Parliament, signed and published in the Bulletin of Acts and Decrees before it can enter into force. It is expected that this will happen sometime in 2020.*[1]

On paper, the Dutch scheme looks to be both flexible and radical. Whether it will be the game-changer that the Dutch hope it will be remains to be seen. As with any new regime, the proof will be in the pudding and in the continued application and consistency of judgments that will need to be given for anyone to be confident in its use.

On July 8, 2019, the legislative proposal providing for court confirmation of a private[2] restructuring plan (*Wetsvoorstel homologatie onderhands akkoord*) (hereinafter, the "proposal") was submitted to the Dutch parliament. The proposal introduces a fast and efficient *pre-insolvency* procedure to restructure a company's business through a scheme between the company and its creditors and/or shareholders, with the possibility of a *court-approved, cross-class cramdown* if just one in-the-money class has voted in favor of the proposed plan.

The new scheme procedure is meant to serve as a last-resort pre-insolvency restructuring tool, designed as a framework procedure with a court's limited involvement. The proposal features elements of the U.S. chapter 11 procedure and the U.K. scheme of arrangement. The Dutch insolvency legal framework currently does not provide for the possibility to restructure a business outside of insolvency and out of court through a scheme that is binding toward its creditors and shareholders.

There has been a growing demand for a practical restructuring tool outside the formal insolvency procedure. The proposal needs to be approved by the Dutch parliament, signed and published in the Bulletin of Acts and Decrees, after which it will come into force, most likely in the course of 2020.

Jurisdiction and the "Two Versions"

If the debtor's center of main interests (COMI) is located in the Netherlands, the Dutch court will have jurisdiction on the grounds of the European Regulation on Insolvency Proceedings (the "EIR"). If the debtor's COMI is outside the European Union (or in Denmark), then the Dutch courts can still exercise jurisdiction over the debtor, provided that there are close ties with the Netherlands. This is on the basis of the Dutch Code of Civil Procedure generally.

The proposal provides for two types of restructuring proceedings: a public version and an undisclosed (*i.e.*, private)[3] version. The entity that initiates the procedure may choose the type of preferred procedure. It is not possible to switch between the types during the proceeding.

The public version, which will be publicly announced in the insolvency and trade registers,

1 There is no official translation of the draft law available yet.

2 "Private" as used in the title of the legislative proposal ("*onderhands*"): The "scheme" is an informal out-of-court debt rescheduling and restructuring process. Because the proposal offers an effective means of imposing a court-confirmed solution, dissenters are less likely to be overdemanding. This will facilitate an agreement. The role of the court up until the homologation hearing is — in principle — limited (unless the debtor involves the court before that time). In addition, the debtor retains control over its business and may continue to run it during the plan procedure (a "debtor in possession").

3 The proposal provides for two types of proceedings through which the plan can be put into effect: (1) an undisclosed ("private") version and a (2) public version. In the undisclosed version, the intention of the debtor or restructuring expert to propose a plan is not made public and all requests to the court are considered in judge's chambers. A choice must be made between the two procedures.

will automatically be recognized in other European Union member states under the EIR if the debtor's COMI is located in one of the member states. The private version, which is exempt from publication requirements, would not be automatically recognized under the EIR.

Timing: When Can a Plan Be Filed?

A plan can be prepared and initiated by a debtor if it is reasonably plausible that the debtor will be unable to pay its debts when due. The procedure is also available when the debtor foresees that it will be unable to pay its debt when due in the (near) future (*e.g.*, even in six months or a year). In addition, one or more creditors, shareholders, or a works council or trade union have the right to initiate the debtor's restructuring. They can request that the court appoint a restructuring expert to prepare and start the process.

Stay and *Ipso Facto* Clauses

Any request to open insolvency proceedings will be suspended during the scheme process. There is no automatic stay upon the filing of the plan, but a debtor can ask the court to order a stay for up to four months, extendable up to a maximum of eight months total. If a stay is granted, it prevents all or certain parties from taking recourse against or claiming the debtor's assets, except with the court's permission. In addition, attachments against the debtor might be lifted.

However, a debtor remains entitled to use its goods and collect claims during the stay. Upon the filing of a plan, contractual provisions that allow the debtor's counterparty to terminate, amend or suspend a contract, or provide for automatic termination, become inoperative.

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Content of the Plan and Class Formation

A plan can make amendments to the rights of *all* creditors and shareholders, both secured and unsecured, or only of certain (groups of) creditors or shareholders. The proposed scheme can also include a debt-for-equity swap. However, the plan cannot affect rights arising from employment contracts.

In addition, a plan must meet the "best interest of creditors test" (*i.e.*, creditors cannot receive less under the plan than they would in a liquidation and must have been offered a cash-out against liquidation value) and respect the "priority rule" (*i.e.*, the plan must allocate the reorganization value of the company among the classes in accordance with their statutory ranking, but deviation from this rule is possible).

Creditors must be placed into voting classes depending on their respective legal positions. If the legal positions in a liquidation or after adoption of the plan are so different that their exposure is not comparable, they need to be placed in different voting classes. Although a debtor can choose the content of and who to include in the plan, certain formality requirements must be met. Among others, the plan must contain all information that creditors and shareholders need in order to form an informed view of the plan.

Guaranties, Executory Contracts and DIP Financing

If there is a third-party guarantor, then, following plan confirmation by the court, the creditor can claim against the third party for the payment of that debt. The third party does not have the right to recover from the debtor. However, there is an exception for guaranties that have been issued by entities that are members of the same group: If certain requirements are met, the plan can provide for an amendment of the rights of the creditor toward a surety or joint debtor, meaning that the surety will also be either released or liable only for a compromised amount by the plan.

With the court's permission, a debtor can terminate any executory contract, including lease contracts (but not employment contracts), if the counterparty does not agree with any modification proposed by the debtor. Where permission is granted, the counterparty is entitled to claim damages that can be rolled into the plan. After a debtor has filed a statement indicating that it has started preparing a plan or that a restructuring expert has been appointed, funding required during the restructuring efforts (including related granting of security) is protected from clawback if the court approves such financing.

When the Plan Is Accepted and the Use of Cramdown

All creditors and shareholders whose rights are affected by the plan are entitled to vote. Those whose rights are not affected do not need to be informed about the plan, and they cannot vote. The plan will be voted on by each class. A class has accepted the plan if the creditors voting in favor represent at least two-thirds in value of the total value of claims of those that voted within that class (no head-count test). For shareholders, at least two-thirds of the issued capital of those who voted within that class must vote in favor.

The plan is accepted in any event if all classes vote in favor. Where this is not achieved, the debtor may ask the court to confirm the plan (by way of cross-class cramdown) if the plan is approved by at least one "in the money" class. The plan is accepted in any event if all classes vote in favor. Where this is not achieved, the debtor may ask the court to confirm the plan (by way of cross-class cramdown) if the plan is approved by at least one class. This needs to be

an "in the money" class if the position of 'in the money' creditors is being affected by the plan.

The court will hear the request for court confirmation between eight and 14 days after the debtor has submitted the plan for court confirmation. The court can decide not to confirm the plan at its own motion or at the request of a creditor or shareholder if, for example, formal requirements have not been met or the classes have not been properly constituted. The court can refuse confirmation at the request of creditors or shareholders who voted against the plan who invoke the best-interest-of-creditors test or "priority rule." The court's decision is not subject to appeal.

After confirmation by the court, the plan is binding on all creditors and shareholders who are involved in the plan and were entitled to vote. This means that out-of-the-money classes, along with creditors and shareholders who did not vote or who voted against the plan, are bound.

Achieving Deal Certainty and Speed

A debtor or restructuring expert (if one is appointed) can request that a court consider matters that could increase deal certainty (such as classification of creditors, valuation or sufficiency of information) prior to voting on the proposed plan. The formal procedure, taking into account the statutory time periods, can possibly be as short as three to five weeks from the moment the debtor makes the draft plan available. (This should be done at least eight days before a vote is set to take place. Subsequently, the debtor must present a voting report at least seven days after the vote.) This does not include the time required for commercial negotiations prior to the voting process, during which period the debtor may or may not seek to have the benefit of the stay, or the time required for the court to render a decision, which is likely to be between one and three weeks.

Conclusion and Next Steps

Adoption of the scheme would give debtors a fast and efficient tool to restructure their debts, enhancing options for pre-insolvency business rescue in the Netherlands. The regime combines the elements of the U.S. chapter 11 procedure and the U.K. scheme of arrangement, while expediting the process through increased flexibility and minimal court involvement.

It is expected that the Dutch procedure will be of particular appeal in cross-border group situations, given that many group structures involve a Dutch holding company. The process will be attractive for an entire group, as it is available for more than just Dutch-incorporated companies or debtors with their COMI in the Netherlands. The flexibility of choosing whether to use a public process (with the automatic recognition in the European Union through the EIR) or a private process will also add to its attractiveness.

While the proposal is subject to parliamentary approval before it can be enforced, the new regime would be a welcomed step toward a modernized insolvency regime in the Netherlands. This may be a game-changer not just for European restructurings, but, with its speed and reduced costs, it could also evolve to be a real competitor to chapter 11. The proof will then be in the pudding, and practitioners will have to see whether the Dutch courts develop a consistent and commercial practice in interpreting the law, much as the English courts have done (which is an important feature in the fact that the U.K. scheme of arrangement continues to be a popular choice — as the predictability is already there). abi

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