REVISED DRAFT "DUTCH SCHEME (WCO II)"

On 5 September 2017, the Dutch ministry of security and justice published a revised draft bill which will introduce the possibility in Dutch bankruptcy law for companies in financial distress to cram down their creditors and shareholders in order to restructure their debts.

The aim of the draft Dutch Continuity of Enterprises Act II ("WCO II") is to enable a company to restructure its debts through the incorporation of a plan, which can, after sanctioning of the court, be imposed on dissenting creditors and shareholders. The draft bill contains elements of both the English law scheme of arrangement and the US Chapter 11 proceeding. The current draft was published three years after the first draft of the WCO II. In this second draft, various concerns are addressed that were raised during a formal consultation process.

Notable amendments in the Dutch scheme

The second draft WCO II implements some significant changes to the Dutch Bankruptcy Act (*Faillissementswet*) compared to the first draft of the WCO II. Most notable is the incorporation of several features from the American Chapter 11 of the US Bankruptcy Code ("**Chapter 11**"), which offers distressed companies a wide range of rescue and/or restructuring options. The revised draft WCO II for example includes (i) the temporary stay, (ii) the best interest of creditors test, (iii) the absolute priority rule and (iv) the exclusivity period of 30 days in which distressed companies have the sole discretion to propose a plan to its creditors and shareholders.

Furthermore, pursuant to the new draft WCO II, a distressed company can request the court to settle any disputes arising during the negotiations of the plan. Also, the draft WCO II grants a debtor the right to renegotiate term contracts, as well as the option to terminate the contract if parties cannot agree on a variation.

The Dutch scheme in practice

If a company foresees that it will no longer be able to pay its due and payable debts, it may propose a plan to all or some of its creditors and/or shareholders which will result in an amendment of their rights. A creditor can also request a debtor to propose a plan. If the debtor refuses, the creditor may request the

Key issues

- Revised draft bill WCO II published;
- Introducing a new instrument for restructuring financially distressed companies outside of bankruptcy under court supervision;
- The Dutch legislator draws inspiration from the English law scheme of arrangement and the US Chapter 11 proceeding;
- On the instigation of a debtor or creditor, a plan for restructuring debts can de proposed;
- WCO II offers the possibility of a temporary stay after proposing a plan;
- A plan which is accepted by one class of creditors or shareholders can be declared universally binding by the court;
- Dissenting classes can be crammed down;
- Only one court hearing is required;
- The WCO II incorporates the best interest of creditors test, absolute priority rule and new value exception.

court to appoint an expert to propose a plan. After proposing a plan, the debtor can request the court to order a temporary stay (*afkoelingsperiode*) for a period of four months maximum. During this period, a creditor can only take recourse against the assets of the company after court approval.

If the plan concerns creditors and/or shareholders whose interests or rights are materially different from the interests of other creditors or shareholders, the creditors and/or shareholders that are affected by the plan are placed in separate classes. Creditors and shareholders who would have a different ranking in bankruptcy must in any event be placed in separate classes.

The debtor brings the plan to a vote, whereby the creditors and/or shareholders whose rights are affected by the plan have the right to vote. The plan is accepted by a class of creditors if a group of creditors votes in favour of the plan, which group must jointly represent at least two third of the relevant debt. Under the current wording of the draft, a debate can arise on whether such group of creditors (representing 2/3 of the debts) must adopt the plan by unanimous vote, or whether at least 50% +1 votes in favour of the plan within such group will be sufficient. If the latter would be the case, only a (group of) creditors representing 34% of the debt would have to vote in favour of the plan (i.e. 50%+1 of 2/3). In our view, this would be a rather low threshold. We would therefore support editing the wording of this clause to clarify that a (group of) creditor(s) representing 2/3 of the debts in the relevant class should adopt the plan by unanimous vote. For a class of shareholders, a qualified majority applies of two third of the votes. If at least one class voted in favour of the plan, the company may request the court to declare the plan universally binding (*homologatie van het akkoord*). The WCO II thus provides for a cram down of classes who voted against the composition.

Grounds for refusal of a proposed plan

Despite all impaired classes voting in favour of the plan, the court will (at the request of an individual dissenting creditor or shareholder) refuse to declare the plan universally binding if:

(i) the plan is fraudulent;
(ii) performance of the plan is not warranted;
(iii) the voting process was flawed or other formal requirements have not been met;
(iv) a creditor or shareholder would receive less under the plan than it would receive in bankruptcy (the 'best interest of creditors test'); or
(v) other reasons compel the court to do so.

If one or more classes vote against the plan, the court will refuse to declare the composition universally binding in the event of:

(i) a class of creditors or shareholders is not being paid in full while a more junior ranking class obtains or retains a financial interest in the company (the 'absolute priority rule'), *unless* this interest is consideration for providing new credit or equity;
(ii) a junior ranking class will not retain anything under the composition while a more senior ranking class will be paid more than 100% of their claim;
(iii) unfair discrimination between classes;
(iv) creditors that would be entitled to a monetary payment in bankruptcy are being forced to accept payment in another form (i.e. a debt for equity swap).

With this provision, the new draft WCO II introduces the absolute priority rule in the Dutch Bankruptcy Act. As a basic framework, the absolute priority rule entails that a dissenting class of creditors or equity holders cannot be compelled to accept less than full compensation if a more junior creditor or equity holder receives anything or retains its interest under the plan. Furthermore, a senior class may not receive more than 100 per cent of its claim where a dissenting junior class will receive less than 100 per cent. The inclusion of the absolute priority rule increases the importance of a correct valuation of financially distressed companies.

In general, we note that the draft WCO II leaves little discretion for the courts to determine whether to confirm a plan. We would support implementing a test for reasonableness or an exception for cases of abuse of rights by a dissenting creditor or shareholder.

Conclusion

The second public consultation procedure for the draft WCO II, which started on 5 September 2017, offers interested parties the opportunity to give their input to the Dutch legislator. The consultation procedure will end on 1 December 2017. Next, the draft WCO II will need to be approved by the Dutch Parliament (*Eerste en Tweede Kamer*) before it will come into force.

The second draft WCO II is an improvement compared to the first draft bill and we believe that if and when this new draft bill will come into force, the Dutch Bankruptcy Act gains a powerful instrument to restructure distressed companies.

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