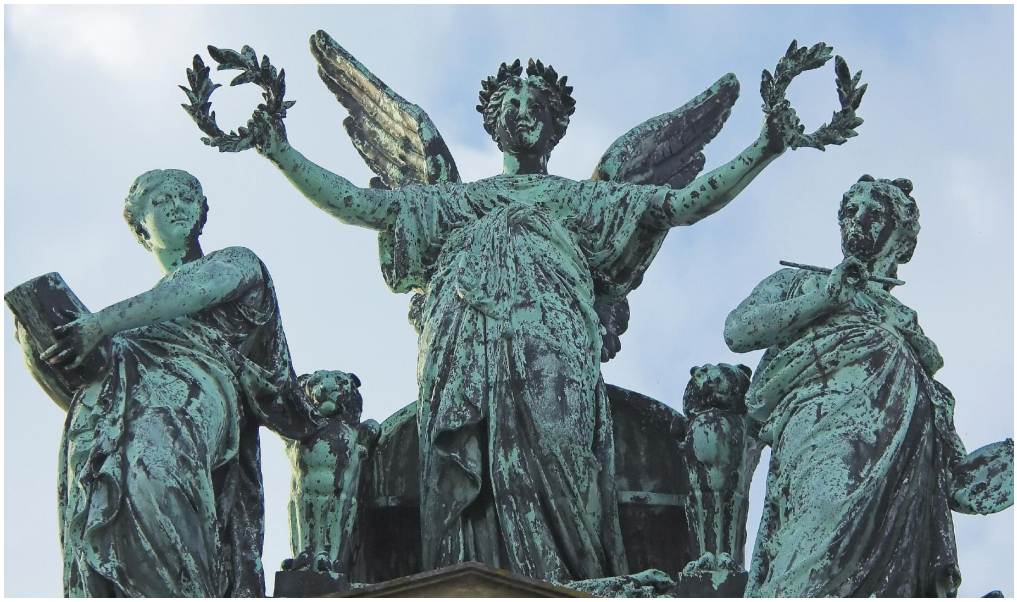
New Dutch bankruptcy legislation... Finally!

Evert Verwey looks closely at the first part of the new Act on 'Pre-Packs'



> THE DUTCH LEGISLATOR ANNOUNCED IN 2013 THAT THE "CONTINUITY OF COMPANIES" WAS A PRIORITY

Introduction

The Dutch Bankruptcy Act (*Faillissementswet*) first came into force on 1 September 1896, making it relatively old for a Bankruptcy Act. In 2011 the legislator decided that a new draft of the Dutch Bankruptcy Act was not a priority and there was no need to adopt amendments.

Surprisingly, the Dutch legislator announced in 2013 that a new bankruptcy law was in fact necessary and that the "continuity of companies" was a priority. It was announced that three new acts would be drafted:

- ***Act on the Continuity of Companies I: Pre-pack proceedings***
- ***Act on the Continuity of Companies II: Composition outside bankruptcy proceedings***
- ***Act on the Continuity of Companies III: Duty for suppliers to continue to supply in bankruptcy***

On 22 October 2013, the Dutch Minister of Security and Justice presented a draft bill for an Act on the Continuity of Companies I, which aims to provide a statutory basis for the appointment of a silent trustee. Interested parties were given until 21 January 2014 to comment on the draft bill, after which it will be submitted, possibly in amended form, to the Dutch parliament.

Dutch Bankruptcy Act

There are currently two main insolvency proceedings which may be commenced under the Dutch Bankruptcy Act (a third option is a debt rescheduling scheme (schuldsanering) for natural persons):

(i) bankruptcy (*faillissement*): the debtor's assets are liquidated by the court-appointed trustee (curator); or

(ii) suspension of payments (*surseance van betaling*): the debtor is given temporary relief against creditors in order to reorganise and continue the business, and ultimately to satisfy (part of) the creditors' claims under supervision of a court-appointed administrator (*bewindvoerder*).

Since 2012, there have been a number of successful "pre-pack" restructurings in the Netherlands. A pre-pack is the definition used for the restructuring of a company through a transaction that is prepared as much as possible before formal bankruptcy

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> THE DISTRICT COURT MAY APPOINT A SILENT TRUSTEE 'SILENTLY', MEANING THAT THE APPOINTMENT IS CONFIDENTIAL

proceedings commence. The aim is to ensure maximum preservation of the value of the business. The district court is requested to appoint a so-called "silent trustee", who is informed of the ongoing negotiations with the relevant stakeholders (usually management, secured creditors and potential buyers). Once the stakeholders have agreed upon the conditions of the asset transaction, the company enters into bankruptcy proceedings after which the deal is closed by the trustee (who is then no longer silent but is appointed officially by the district court). Often the asset transaction is closed moments after the debtor is declared bankrupt.

There is, currently, no legal basis for the appointment of a silent trustee. In practice, however, most Dutch district courts do appoint a silent trustee upon request of a company in distress. In cases of threatening insolvency which is likely to have a significant impact, several district courts inform the company upon their request who they intend to appoint as bankruptcy trustee. The Dutch Minister of Justice is said to have noticed this practice and thought it necessary to draft a new act which establishes a legal basis for the appointment of a silent trustee.

(Draft) Act on the Continuity of Companies I (the "Act")

Appointment of the silent trustee

The Act aims to preserve the value of the company in order to ensure that the liquidation of the company (through bankruptcy proceedings) is more efficient. An additional benefit is that the (negative) publicity following a bankruptcy and uncertainty for suppliers and employees is limited avoiding (greater) loss of value of the company. With the appointment of a silent trustee and the preparation in the pre-bankruptcy period of the asset transaction, the proceeds thereof will be higher and the creditors will have a better chance of receiving higher returns from the bankruptcy estate.

The district court may appoint a silent trustee *silently*, meaning that the appointment is confidential. A request for the appointment of a silent trustee will be granted if it is likely that such an appointment will be in the interest of the creditors as a whole or in the public interest, or if the continuity of the business and the preservation of jobs will be served by such an appointment. The request has to clarify why the appointment of a silent trustee is preferable to immediate bankruptcy. The request further describes the intentions of the pre-pack proceedings through a milestone-plan.

The court appoints a silent trustee and a (silent) supervisory judge for a specific term after a prima facie examination of the

> CRITICS OF THE PRE-PACK PROCEEDINGS ARGUE THAT THERE IS NOT ENOUGH TRANSPARENCY

milestone-plan. The silent trustee has no authority over the company and no powers to represent it. The company (through its directors) retains the exclusive possession of its assets and is in full control. The silent trustee acts in the interests of all of the company's creditors and receives information from the company in the stage before the bankruptcy proceedings.

The Act provides that a silent trustee is entitled, upon request of the company, to give his view on certain matters. The company may ask a silent trustee to give his view on certain transactions carried out by the company during the pre-pack proceedings, to assess if such transactions would be detrimental to its creditors and to confirm that he would not try to annul that transaction once the company enters into bankruptcy proceedings with his appointment as trustee. The company may ask the silent trustee to give his view on the proposed transaction and his willingness to close the deal once he is appointed by the district court as a trustee. This gives certainty to the stakeholders prior to the bankruptcy and leads to a faster conclusion of the asset transaction without the business having to cease its activities or the uncertainty that the trustee will annul certain transactions. The business continues without unnecessary interruption.

Bankruptcy proceedings

Once the approved silent trustee has given his *blessing* to the asset transaction, the company will file for bankruptcy. Thereupon the asset transaction will be closed (often) the same day. The supervisory judge (whose appointment was likewise not published) will already have been informed by the silent trustee of the details of the asset transaction and will give his approval as well. The trustee then usually dismisses all of the company's employees and the buyer of the assets will continue the business by offering key personnel new employment contracts. The buyer of the assets will pay the agreed transaction sum to the trustee for the assets. If the assets are secured by a security right the secured creditor will have to release the security rights (after receipt of the agreed amount).

Criticism

The combination of confidentiality and a tight time frame does not allow market research and a full marketing process to achieve a high(er) return for creditors. Therefore the silent trustee has to examine the value of the business by means of external benchmarks and other comparisons. Critics of the pre-pack proceedings argue that there is not enough transparency. There is also discussion whether a pre-packaged asset transaction qualifies as a transfer under the European Union Business Transfers Directive in connection with the employees who are given new employment contracts.

Conclusion

In general pre-packs restructurings are an improvement to the existing insolvency proceedings. The alternatives are often detrimental to the value of the company. Owners of the company are often deterred by the complete loss of control that accompanies a bankruptcy, not knowing in advance how a trustee will handle the situation and the interested potential buyers that come forward. At the same time it is expected that a pre-packaged asset transaction will preserve the value of the company and as a consequence, a higher return for the creditors. ■

Share your views!