The Dutch Scheme of Arrangement is Coming?

Some observations from an English perspective on the Out-Of-Court Composition ("OOC Composition") proposed in the draft Dutch bill on the Continuity of Companies Act II (the "New Dutch Bill")

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New Recital 4 of the EU Insolvency Regulation

• “It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position to the detriment of the general body of creditors (forum shopping)” [emphasis added]

• “Good” forum shopping — avoid value destruction and promote rescue of the business

• “Bad” forum shopping — escape (in a prejudicial fashion) certain creditors and liabilities
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OOC Composition Does Not Equal Dutch Scheme of Arrangement

- Building expectations that cannot be met
- Risk of misleading market parties with knowledge of and experience with the original concept
- Do not underestimate the significant differences that exist
English Scheme v. Dutch OOC Composition

• English Companies Act 2006 v. Dutch Bankruptcy Act
  – Broad use of English Scheme
  – Jurisdiction — use of English Schemes to restructure non-English companies

• Court involvement
  – Importance of early court involvement in English Scheme process
  – Option to appoint Dutch Supervisory Judge in Dutch OOC Composition process (Article 371)

• Treatment of so-called “out-of-the-money creditors”
  – Transfer Schemes
  – Valuation
  – Cross-class cram-down option (Article 373(2))
Examples of Broad Use of English Schemes

• **Creditor schemes**
  – Release, compromise of debts (secured or unsecured) or change of ranking
  – Debt-to-equity exchange
  – Transfer of assets from the debtor to a new company
  – Transfer of claims amongst Scheme creditors
  – Amendment to existing agreements or entering into new agreements
  – Release of rights of action

• **Member schemes in respect of UK- incorporated company**
  – Take-over
  – De-merger
  – Add new holding company
  – Return capital to shareholders
  – Remove minority shareholders
  – Internal group reorganisations
Jurisdiction

• **Companies Act 2006** - two limbs test
  – The Scheme companies *must be liable to be wound up* under the Insolvency Act 1986; and
  – The English court must be sufficiently comfortable that its *order sanctioning the Scheme will have effect* in the relevant foreign jurisdiction(s) (through formal recognition or otherwise)

• **NEF Telecom case (JOR 2013/58 and 59)**
  – Choice of English law + English courts = Sufficient connection with the UK
Jurisdiction Continued

• **EU Insolvency Regulation v. Judgments Regulation**
  – If Judgments Regulation covers sanctioning of English Scheme, then recognition throughout Europe unless valid public policy argument

• **Magyar case (JOR 2014/181)**
  – Transfer of COMI to England to meet "sufficient connection with UK" requirement
  – English Scheme Proceedings were granted US Chapter 15 relief and recognised as "Foreign Main Proceedings"
Dutch OOC Composition

• COMI is the test for jurisdiction
  – Article 374(1)(c) of the New Dutch Bill

• Availability to non-Dutch companies?
  – How easy is a COMI shift?

• Missed opportunity?
Court Involvement — UK

• Three-stage English Scheme process
  – Convening of Meetings Stage: an application to the court for permission to convene the relevant meeting(s) of creditors or members (or the relevant class(es) of them);
  – Voting Stage: approval by the required majorities of members or creditors (or the relevant class(es) of them) at those meetings; and
  – Sanctioning Stage: an application to the court for an order sanctioning the Scheme and, if granted, delivering that order to the Registrar of Companies

• Class constitution challenge must take place at first court hearing

• Class composition test

  “Creditors whose rights are so dissimilar as to make it impossible for them to consult together with a view to their common interest are required to vote in separate classes.”
Court Involvement — The Netherlands

- **Article 371** of the New Dutch Bill — option to apply for the appointment of a supervisory judge
- **Anticipated role of supervisory judge**
  - **Class composition**: provide guidance on compliance with requirements the court applies in the context of a sanction hearing for the method of assessment for creditor claims and class composition for voting purposes;
  - **Changes to OOC Composition**: provide guidance on whether the OOC Composition proposal requires any amendment or addition which would reasonably be necessary to enable the creditors and shareholders whose rights are amended to come to a sound assessment; and
  - **Voting**: decide if and to what extent a creditor or shareholder is admitted to vote in the event of a difference of opinion about the admission to vote of a creditor or shareholder or about the amount of the claim of a creditor
- **Article 369(2)** of the New Dutch Bill — focus on similarity of rights
Court Involvement — UK

• Common class issues in English Schemes
  – What is the appropriate comparator for assessing differences in rights between creditors for class composition purposes?
  – What are rights and what are collateral interests?
  – Should cross-holdings result in different classes?
    creditor/shareholder
    lender/bondholder
    lender in different tranches
  – Should intercompany claims be a different class?
  – Should creditors with a lock-up or voting arrangement (with or without related consent fees) with the debtor be a different class?
  – Should creditors who are offered different options under a Scheme be a different class?
  – How does one deal with different interest rates and maturity dates under facility agreements?
  – How do you deal with foreign creditors and foreign laws?
Court Involvement — The Netherlands

• **Policy**  avoid overburdening the Dutch courts
  – *English experience:* Court involvement early in the process avoids unnecessary costs and court time later on
  – *In practice:* Supervisory judge option is likely to be exercised in every case
    • Entire OOC Composition process is new
    • In particular, class composition issues are new in the Netherlands

• **Appeals**  while supervisory judge statements and decisions are not subject to appeals, they can be revisited by the court in the context of a sanction hearing
Treatment of Out-of-the-Money Creditors

• Secured Debt Transfer Scheme
  – The Scheme is used to compel any dissenting “in-the-money” secured creditors to accept the new transaction;
  – The sale (either security enforcement by the directors or administration sale) is used to transfer the Collateral (usually operating subsidiaries) to a third party (usually a NewCo owned the “in-the-money” secured creditors); and
  – The sale should activate the release and transfer provisions under the intercreditor agreement so as to allow for a release or transfer of the security, guarantees, primary borrowing obligations and any intercompany claims

• Unsecured Debt Transfer Scheme
  – Combines a Scheme with a sale (either by the directors of the debtor or an administrator) of all or substantially all of the assets of the debtor to NewCo (owned by the “in-the-money” creditors) in order to leave behind the out-of-the-money creditors and shareholders
Valuation

• As a general rule, creditors without an economic interest are not entitled to vote on a Scheme and, therefore, do not have to be involved (Re Tea Corporation Ltd [1904] 1 Ch 12)

• Valuation key to determine where the value breaks

• The court will typically expect both:
  – Expert valuation reports; and
  – Evidence of a market-testing sales process to generate real offers for the assets

• More focus on price offered by potential buyers than valuations that take into account potential future value
OOC Composition

• **Article 373(2)** of the New Dutch Bill — “cross-class cram-down” option which the court upon request may exercise during the sanction hearing

• **The relevant test** *In the court's opinion, the classes that did not vote in favour of the OOC Composition could not reasonably have come to such voting behaviour*

• **Article 369(3)** of the New Dutch Bill — also, out-of-the-money creditors and shareholders are granted a right to vote provided that the proposed OOC Composition changes their rights — Valuation issues just postponed until the sanction hearing?
Conclusions

• The OOC Composition proposed in the New Dutch Bill is clearly a **positive step which deserves broad support**

• I have posed two main questions
  – Should the OOC Composition be **designed as a more flexible concept** so as to allow a broader use by non-Dutch companies in a similar way as the English Scheme?
  – In addition to the sanction hearing at the end, should there be another **mandatory court hearing incorporated earlier** in the OOC Composition process?

• Do **not** market the OOC Composition as the Dutch Scheme of Arrangement, because it is not

**UK (London) should not fear losing its prestigious title any time soon.....!**