Insolvency in the Netherlands

Juliette van de Wiel and Ruben Berghuis

The current economic climate: calm before the storm?

A big wave of insolvencies has been anticipated in the Netherlands ever since the COVID-19 pandemic hit Europe at the beginning of 2020. So far, those expectations have not materialized. In fact, the number of bankruptcies in the Netherlands is at an all-time low.

Is this the calm before the storm? The low number of bankruptcies is at least partly the result of state aid to compensate for loss of revenue due to the measures to limit the spread of COVID-19. Even unviable companies that might not have survived under normal circumstances managed to stay afloat thanks to the state aid. Circumstances are changing, however. State-aid measures recently ended, inflation and energy prices are sky-rocketing, and starting in October 2022 companies will need to start repaying their deferred taxes from the past two years. Additionally, major personnel shortages are becoming an issue in almost every sector of the Dutch economy. It seems that at some point in the near future more companies will face difficulties in managing all these challenges simultaneously.

Supposing the storm breaks, businesses will face an increase in applications for insolvency and restructuring proceedings by their Dutch trade partners. What follows is a brief overview of these proceedings, with a discussion of the key questions that businesses are likely to come across when dealing with an insolvent debtor.

Proceedings for insolvent legal entities

The Dutch Bankruptcy Act provides for three types of proceedings for businesses in financial distress: a court-approved private composition, suspension of payments, and bankruptcy. For natural persons, there is also the debt restructuring scheme, which after three years provides a

Juliette van de Wiel

“Even unviable companies that might not have survived under normal circumstances managed to stay afloat thanks to the state aid. Circumstances are changing, however.”

“Petitioning for a debtor’s bankruptcy is accepted as a means of debt collection.”

“clean slate”, or a discharge from liability for all debts, if a series of strict conditions are satisfied.

In addition, Dutch company law offers legal entities with debts but no assets the possibility to dissolve through a “turbo liquidation” process. Lastly, in recent years the practice of the “pre-pack” has been developed. In a pre-pack, during the weeks prior to the public bankruptcy proceedings the debtor, working under the supervision of the intended bankruptcy trustee, prepares a going-concern sale of the company. Following his formal appointment, the trustee can then immediately conclude the prepared transaction. The aim is to achieve the best proceeds by avoiding a decrease in the company’s value simply because it becomes public knowledge that the company is in bankruptcy proceedings. Dutch trade unions, however, see the pre-pack as a way to circumvent dismissal protection rules. Where employees can be dismissed without cause if the company is in bankruptcy, the possibilities for dismissing employees outside of bankruptcy are still fairly limited and expensive. Employees’ rights in relation to the pre-pack have therefore been a topic of much heated discussion in the past years, creating uncertainty about the legal sustainability of the pre-pack procedure, and consequently the procedure has fallen into

disuse. Nevertheless, following developments in European case law in the spring of 2022, the pre-pack procedure is likely set to enjoy a revival.

Dutch Scheme (WHOA)

The WHOA, introduced in 2021, is the latest addition to the Dutch restructuring framework. “WHOA” is the abbreviation for the name of the act (Wet Homologatie Onderhands Akkoord) that introduced this procedure. It is a pre-insolvency procedure aimed at restructuring through a creditor composition, with features similar to the “scheme of arrangement” in the UK. In theory, any court involvement is limited to approving the composition. The procedure is widely viewed as a very welcome addition to the existing proceedings because of the many possibilities it offers. Most prominently, where a qualified majority votes in favour of the offered composition, the WHOA enables the debtor to bind obstructing creditors to that composition. Throughout the procedure, the debtor remains in possession, he can choose to include all or only part of his creditors, including shareholders, secured and preferential creditors, he can request termination or amendment of long-term contracts, and he can request a standstill period. Further details of the WHOA are discussed elsewhere in this magazine.

Suspension of payments

The suspension of payments procedure constitutes an immediate, temporary relief of payment obligations but is only binding for unsecured creditors. Secured creditors and creditors with preferential rights such as employees and the tax authorities must be paid in full, as well as all new obligations arising on or after the suspension date, which is in fact one of the reasons why suspension of payments proceedings are not common. Another reason is that the route of suspension of payments is sometimes used by a company’s board of directors as an intermediate route to bankruptcy. The board does not need the shareholders’ approval to apply for suspension of payments, whereas it does for a bankruptcy petition.

Only the debtor may apply for suspension of payments. The suspension is granted immediately on a provisional basis, without a substantive assessment by the court. The court will appoint an administrator, whose cooperation is required for any legal acts the debtor wishes to undertake. Although suspension of payments proceedings can be used to liquidate the company, the purpose is generally to ensure a continuation of the business through restructuring of the (unsecured) debts. The debtor may impose a composition

on all unsecured creditors if a simple majority of the creditors votes in favour and a court rules that none of the statutory refusal grounds apply. The possibility to terminate or amend long-term contracts in a suspension of payments, however, is limited to lease agreements.

Bankruptcy

Of the various insolvency proceedings, bankruptcy is most commonly used. The purpose of bankruptcy is liquidation of the debtor's assets by a trustee, under the supervision of a supervisory judge. Bankruptcy constitutes a general attachment on all assets for the benefit of the bankruptee's joint creditors. Both the debtor and its creditors may petition for bankruptcy. As soon as the company has been declared bankrupt, the debtor loses the power to act on behalf of the company. Instead, this power is taken over by a court-appointed trustee, who exercises it in the interests of the joint creditors. Within one or two days following his appointment, the trustee will generally dismiss all employees, subject to a maximum notice period of six weeks. Wages are covered by the employee insurance agency, UWV. During this first phase of the bankruptcy the trustee reviews the possibilities for selling the business as a going concern, as this usually generates higher proceeds than sale of the individual assets. The proceeds are then distributed among the joint creditors, in accordance with their statutory ranking. Although the main goal of bankruptcy proceedings is liquidation, a company could in theory use bankruptcy as a means to restructure its debts, by offering a bankruptcy composition to its creditors. This possibility is rarely used, however.

Bankruptcy as an accepted means of debt collection

It may surprise foreign creditors how easy it is to apply for bankruptcy in the Netherlands. Bankruptcy proceedings will be opened if the creditor provides only summary evidence that he has a claim, that there is at least one other creditor, and that at least one of the claims has fallen due. Creditors often write to debt collection agencies and the tax authorities to inquire whether they are willing to put forward the second claim. The procedure takes only two to three weeks. The debtor may appeal the bankruptcy order, but the bankruptcy has immediate effect nevertheless. The result is often that the bankruptcy becomes practically irreversible, making it an effective means of pressurising debtors.

Petitioning for a debtor's bankruptcy is accepted as a means of debt collection. Particularly if the creditor's claim is not


Ruben Berghuis

overly complicated, there is no need for the creditor to first try to collect the debt through summary proceedings. Creditors should be aware, however, that any payments made to them under pressure of a bankruptcy request may be reclaimed by the bankruptcy trustee if bankruptcy nevertheless follows.

Recovery rate, duration and order of priority

Unfortunately, the recovery rate for trade creditors without security or preferential rights is quite abysmal. In 75% of bankruptcies, there are not even sufficient funds to pay estate creditors – who are paid before all other creditors – such as the trustee, who is compensated for his costs. The average recovery rate in bankruptcies is barely 5%. Considering the average duration of a bankruptcy, creditors will have to wait a year, or sometimes even several years, before they receive payment (if any). In terms of financial compensation, bankruptcy is therefore very rarely in the interests of unsecured creditors.

The low recovery rate is at least partly the result of two developments. Firstly, the number of claims that are accepted by the Dutch Supreme Court as estate claims is growing substantially. Examples of estate claims are the salary of the trustee and his financial advisors, costs of temporarily continuing the business, rental obligations for three months following the bankruptcy date, and claims resulting from environmental protection measures. Secondly, it is becoming increasingly common for all the company's assets to be pledged or mortgaged to the financing bank. Creditors with security rights may enforce their security as if the debtor was not in bankruptcy. This regularly leaves little remaining for creditors with a statutory preference, such as the tax authorities, and even less for creditors who have no preferential rights, who make up the majority.

Retention of title

A more effective means of recovery for suppliers of goods is retention of title. Normally, ownership passes to the buyer on delivery of the goods, regardless of whether the purchase price has been paid. With a contractual retention of title, however, the supplier retains ownership of the goods until full payment of the invoice. The bankruptcy trustee is obliged to respect a valid retention of title, and must offer the supplier the opportunity to collect the products. This does not apply to the tax authorities: under certain conditions, they may recover their claims on the insolvent company by taking recourse against a supplier's goods that are located on the company's premises. This quite

extraordinary power has been debated for many years, but so far no compromise has been reached. Suppliers should furthermore be aware of the practical implications. For example, they can only recover their goods if they can indicate (and prove) exactly which goods they delivered. This will generally not be a problem in the case of a machine, but it might pose difficulties if the supplier is one of several vendors delivering a particular product.

Director's liability and mandatory review into fraudulent acts

As a general rule, directors of a legal entity are not liable for the entity's debts. The threshold for director's liability is high, to prevent defensive behaviour from directors. In addition to the grounds for director's liability under general tort law and company law, however, bankruptcy trustees have two additional grounds for invoking director's liability. Firstly, they may hold all members of the board of directors personally liable for the full bankruptcy deficit if they have manifestly mismanaged the company and their mismanagement is likely to be an important cause for the bankruptcy. Liability is assumed if the directors did not keep proper records or did not file the company's annual report (or at least not on time). Secondly, the trustee may claim liability based on an act of tort towards the joint creditors. An individual creditor may also bring a separate claim for liability towards the director, but the court will first rule on the trustee's claim if the claims are pending simultaneously. The trustee's statutory duties were recently extended to include a mandatory review into potential "irregularities" and fraudulent acts during the period preceding the bankruptcy. If the trustee uncovers any prejudicial acts, he is expected to notify the criminal judicial authorities accordingly. Discussion exists about whether it is fair and appropriate for the trustee's duties to serve this public interest, given that they are financed by the creditors (who are not paid until after the trustee) or the trustee themselves (if the estate funds are insufficient).

Actions for fraudulent conveyance

Creditors should also be aware of a bankruptcy trustee's power to nullify legal acts that were conducted prior to the bankruptcy – legal acts that the creditor knew, or should have known, would be disadvantageous to the joint creditors. Acts might be disadvantageous the joint creditors for a number of reasons, but the primary example is the situation where the act diminished the possibilities for recovery from the estate – basically, decreasing the value of

the total assets. One can think of the a sale of goods at an excessive discount or on non-market terms, or by offsetting the purchase price against an outstanding invoice. Typically, this covers legal acts that were conducted in the vicinity of insolvency. It is, however, not uncommon for acts conducted a year before the bankruptcy declaration to be successfully nullified. Because of the trustee's power to nullify legal acts, creditors should be aware of the circumstances and conditions under which an agreement or transaction is concluded, particularly if their contracting party is known to be in financial difficulty.

Creditor's information and consultation rights

Bankruptcy proceedings in the Netherlands tend to last at least one year (on average). In more complicated bankruptcies, it might even take several years to liquidate the estate. During the course of bankruptcy proceedings, the trustee must file public reports on the progress of the proceedings and on his management of the estate. The first report is filed after one month, with subsequent reports being filed every three months. The reports are made available through the website of the Dutch judicial organisation. The trustee is not required to inform individual creditors about the progress, nor is he required to consult them. In practice, however, the trustee will occasionally consult creditors (particularly larger creditors) regarding the progress of the bankruptcy or about initiating certain actions such as legal proceedings. Moreover, creditors may in theory ask for a creditors committee to be appointed, although this is rare. That committee has broader information rights than individual creditors do, and the trustee is required to consult the committee in specific situations. In addition, non-estate creditors may also request the supervisory judge to give instructions to the trustee, but this facility is difficult to exercise since it carries strict requirements and may not be used to enforce a creditor's individual rights. This means, then, that the trustee can manage the estate as he sees fit, without being obliged to consult the creditors.

Conclusion

Over the past two years, the global economy has suffered severe disruptions. Add the current uncertainties into the equation, and it should come as no surprise that businesses could face an increase in the number of applications for insolvency and restructuring proceedings by their trade partners in the near future. The Netherlands offers a variety of such proceedings. Bankruptcy is still the most

common of these. It is intended to be creditor-friendly, though in practice the recovery rate is low. In this light, creditors should consider whether petitioning for a debtor's bankruptcy is the most effective means of recovering their claims. Other means of recovery exist, yet these require more advance planning. If it becomes apparent that a trade partner is facing insolvency, it is best for the creditor to ensure that their own financial interests are protected.

If you have any questions about insolvency in the Netherlands, please contact *Juliette van de Wiel* or *Ruben Berghuis*.

vandewiel@dvdw.nl
berghuis@dvdw.nl

You can also visit our website to find out more about the Restructuring & Insolvency team at DVDW.