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Would a Dutch scheme help V&D survive?

This client briefing addresses the issue between V&D and its landlords in the context of the draft bill on continuity of companies II (*Wet Continuïteit Ondernemingen II*), also referred to as the "Dutch Scheme".

The well-known Dutch department store chain Vroom & Dreesmann (V&D) is struggling to survive. In January, V&D announced to take some drastic measures, including a four month postponement of lease payments and a renegotiation of lease agreements with the aim to substantially lower future lease payments for all stores. A number of landlords have strongly opposed to these measures, and one of them has now started summary proceedings requesting the Dutch court to order V&D to evacuate a number of its stores due to non-payment of lease obligations.

Why can't V&D force the proposal upon its landlords?

Dutch law, as opposed to for example English law, does not have a legal basis for V&D to force landlords into lease payment reductions or postponements. These measures will require the consent of each of the landlords involved, unless very specific circumstances apply which would lead to abuse of law. The fact that without these measures V&D would become subject to bankruptcy proceedings does not in itself qualify as a specific circumstance. Also the mere fact that landlords are commercially not willing to agree to an amendment of their lease arrangements to help V&D survive, does not mean that they are abusing the law. It is therefore very difficult, if not impossible, under Dutch law to force a consensual agreement on landlords and even creditors in general in a restructuring process. During formal bankruptcy proceedings a composition of creditors can be adopted with a lower majority than 100%. However, this will not be of help as most (lease) agreements provide for a termination upon insolvency. Furthermore, practice shows that initiating a bankruptcy proceeding causes damage to the value of the business as a whole and too often the business cannot be rescued on a going concern basis.

The proposed Dutch scheme

On 14 August 2014, the Dutch ministry of security and justice published the first version of the draft bill on continuity of companies II (*Wet Continuïteit Ondernemingen II*) whereby a formal consultation process was initiated. If this draft bill is implemented, a company in financial difficulties, such as V&D, will have the possibility to propose amendments to its various creditors and make it subject to a voting process with the involvement of the Dutch court. The idea behind the draft bill is that companies can implement measures, such as currently proposed by V&D, in circumstances where the majority of creditors involved have granted their consent, but not all of them, whereby the non-consenting parties are using their nuisance value to protect their interests. To a large extent, but not completely, the draft bill is comparable to the English scheme of arrangement included in the Companies Act and it has some elements of the US Chapter 11 procedure. At the moment only too often dissenting creditors with only a small stake, and sometimes also out of the money, are able to frustrate the implementation of a Dutch restructuring process outside insolvency. The draft bill is therefore a welcome new development in the Dutch restructuring market.

How does the proposed Dutch scheme work?

Creditors and/or shareholders will be divided into separate classes, whereby those whose rights can be regarded to be reasonably equal each represent a separate class. A voting process takes place whereby the majority requirements are 50% + 1 of votes, representing at least 2/3 of the relevant debts or shares. The composition is accepted

if a majority vote of all classes is obtained, whereupon the Dutch court will be asked to give its blessing. Mandatory grounds for denial of blessing by the Dutch court include insufficient certainty of available funding to implement the composition, unfair voting process or other compelling reasons. If the scheme was not approved by the majority of all classes, the draft bill provides for a further cram down option. The Dutch court is entitled to give its blessing and declare the composition to be universally binding (*algemeen verbindend verklaring*) if the non-consenting parties could not reasonably have voted against the composition. The draft bill provides examples of situations that justify a cram down, including secured creditors who receive more out of the scheme than what they would receive out of a private sale of the secured assets, or shareholders who receive more out of the scheme than out of a bankruptcy process.

Could V&D scheme its landlords?

In principle, the issue between V&D and its landlords is an issue which the proposed Dutch scheme aims to solve. V&D needs the consent of one or more of its landlords to implement measures needed for V&D to survive, in circumstances where not all such landlords are prepared to give their consent. In the Explanatory Memorandum (*Memorie van Toelichting*) to the draft bill, it is specifically mentioned that offering a scheme for the purpose of implementing a financial restructuring can also include a reduction of lease payments, if the lease agreement puts such a financial burden on the company that it prevents a restructuring from being implemented.

If V&D would offer a scheme to its landlords and apply the same new terms to each of them, it is possible that they will all be placed in the same voting class. However, it is equally possible that more classes will apply, for example because the lease agreements each have a different maturity date. Practice will need to show how this works. If the required majority of landlords in all applicable classes vote in favor, and the Dutch court gives its blessing, the new terms will apply to all landlords. If the required majority of landlords does not vote in favor, a scheme could only be forced upon the landlords if the further cram down option is applied whereby the Dutch court declares the composition binding upon all classes, including the non-consenting classes.

This means that (i) the V&D scheme would need to involve more classes of creditors, for example also shareholders and banks, to be able to "catch" the landlords in the scheme as well, and (ii) the Dutch court would need to be able to establish that, taking all circumstances into account, the landlords could not have reasonably voted against the proposal. The test for the Dutch court would, according to the draft bill, be "whether or not the proceeds received by the landlords as a result of the scheme would be more than what they would receive if V&D is liquidated through bankruptcy". Applying this test to a reduction of lease obligations under a continuing lease agreement is complicated. It could also be argued that, in circumstances, it is unreasonable to force new terms upon a landlord, as a result of which such landlord will be bound by these terms for many years to come. For this purpose, the draft bill includes another test, which requires the Dutch court to reject the scheme if it causes the interests of, in this case, the landlords, to be prejudiced in a disproportionate manner. Also here, practice will need to show when this applies. However, the foregoing illustrates that it may not be too easy for V&D to force new lease terms on its landlords by using a Dutch scheme-to be.

The draft bill does not apply to employment contracts

In addition to the proposed measures for landlords, V&D has announced a salary cut of 5.8% applicable to all employees and a redundancy of 50 employees working at V&D headquarters in Amsterdam. Also in this respect legal proceedings have been initiated. The ministry of security and justice has indicated that the draft bill on continuity of companies does not apply to employment contracts. This means that for V&D, even if it was already implemented, the Dutch scheme in itself would not give an overall restructuring solution.

Termination rights under the draft bill

In addition to the tests referred to above, the draft bill provides for another layer of protection to creditors whose agreements and the applicable terms thereto will be amended as a result of the scheme. A general right of termination is included for those parties if the scheme is implemented and as a result thereof their agreements have been amended.

The Dutch court is allowed to apply conditions to such termination. However, the draft bill does not specify in which specific circumstances the termination itself would be allowed, which effectively means that landlords could terminate the lease agreement if (i) the majority of landlords has voted against the scheme but they have been crammed down by the blessing of the court, (ii) a minority of landlords has voted against the scheme, but a majority of landlords has voted in favor, or (iii) even if all landlords have voted in favor of the proposal. Also, the draft bill does not specify to which type of agreements this termination right would apply. Where we can understand that in circumstances a landlord should be able to terminate a lease agreement after implementing a scheme, a termination right should not apply when, for example, the maturity date of a facility agreement is extended and lenders who have voted against such proposal could frustrate the scheme by trying to invoke the termination right. This example illustrates why we think it is advisable for the draft bill to clarify the circumstances in which a termination right exists or, even more importantly, when it should not exist. For example, a party who has voted in favor of a scheme, should not be entitled to subsequently terminate the relevant contract. Also, the draft bill could provide for more clarity as to what type of conditions the court could impose upon such termination.

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