

Global Restructuring & Insolvency Guide

The Netherlands

Overview and Introduction

There are three main types of insolvency proceedings in the Netherlands. A distinction is made between personal insolvency and the insolvency of corporate entities, with a further distinction being made for the latter between insolvencies aimed at liquidation and at continuation.

Applicable Legislation

The most relevant Dutch insolvency legislation ("*Faillissementswet*"; hereinafter the "**Dutch Bankruptcy Act**" or the "**DBA**") dates back to 1893 and has since then only been slightly amended. The European Directives on the reorganisation and winding-up of insurance undertakings and credit institutions have been implemented in the DBA.

In addition to the DBA, EU legislation has a direct impact on Dutch insolvency law. The most important example is the EU Insolvency Regulation (EC No. 1346/2000 on insolvency proceedings), which is directly applicable in the Netherlands. The main goals of the regulation are to create recognition in EU member states of judgments concerning the opening of insolvency proceedings and to set out rules for applicable law issues. The UNCITRAL Model Law on Cross-Border Insolvency has not been adopted in the Netherlands.

The collapse of certain Dutch financial institutions, as well as the global financial crisis, have given rise to a lot of debate as to whether the DBA can still be considered fit to deal with today's economic realities and the highly complex financial issues that arise in bankruptcies. Although preparatory work for revising the DBA has been on-going for many years, no bill has yet found its way into legislation. Moreover, a proposal for a complete overhaul of the DBA, produced by the association for insolvency specialists INSOLAD in 2012, has not found any substantive follow up.

As the legislator continues to fail to modernise the DBA, insolvency practitioners – with the assistance of bankruptcy judges – have developed a practice that overcomes the major issue of "loss of value" associated with bankruptcies. This practice, in essence, has created the option of a pre-packaged bankruptcy filing, which is missing under the DBA. In such cases, before filing for bankruptcy or suspension of payment, the company's management, shareholder or (third party) investor and/or purchaser prepares a plan to acquire or sell certain parts of the business out of the (bankrupt) estate and continue business in another company standing at the ready. Following the preparation of such plan, the court may be asked to appoint a "silent administrator" prior to the request for bankruptcy (or suspension of payment) to ensure that the pre-pack plan is acceptable to the administrator and the bankruptcy judge. This process will prevent delay and limit actions on the basis of fraudulent preference (possibly voiding the sale of the business) and allows (part of) the business to be sold as a going concern. There is currently no statutory basis for the appointment of the "silent administrator," and the process is sometimes heavily criticised for its lack of transparency. However, all but two courts allow it, albeit certain requirements have to be met before an application for appointing a "silent administrator" will be considered by the courts.

In general, the upside of a restart through bankruptcy is that the purchasing company will be able to continue the business with a clean slate, being freed of the burden of costly employees (as cherry-picking is possible and transfer-of-undertaking regulations for a large part do not apply), certain other disadvantageous contracts and old debts. The downsides may be that other interested parties will address the trustee to try and win the healthy components of the business; and negative publicity, which is intrinsically connected to insolvency. If the bankruptcy was not preceded by a silent administration and the trustee feels that the sale is not in the best interests of the combined creditors or that public interests bar such a sale, he is at liberty to set aside the pre-pack, although the bankruptcy judge may be addressed if the trustee chooses a clearly unreasonable path. These

downsides can – to a certain extent – be remediated by requesting the appointment of a silent administrator prior to filing bankruptcy (or suspension of payment). The silent administrator would review whether a deal with a party other than the envisaged purchaser would be more beneficial to the combined creditors.

Personal Insolvency

One type of insolvency proceedings provided for in the DBA is the “debt reorganisation of natural persons”, an alternative to the bankruptcy of a natural person. Restrictions apply: after a three-year period of strict financial control, the debtor will be freed of its debt. For the purpose of this chapter, no further attention will be given to this type of insolvency.

Corporate Restructuring/Reorganisation

As far as debt restructuring outside formal insolvency proceedings is concerned, a debtor may offer its creditors a composition in the form of an agreement. It may also enter into other informal arrangements (standstill agreements with creditors, contractual compromises, etc.). If successful, debt restructuring outside of insolvency may provide for a more advantageous situation; for instance, when it is important to avoid undesired publicity and/or the “lack of confidence” effect connected to formal insolvency proceedings and/or to avoid triggering insolvency-related contractual clauses.

However, such compositions cannot generally be forced upon unwilling creditors and the chance of success is therefore usually limited. Creditors are generally not willing to join a composition or debt restructuring plan unless it involves all creditors, opening the door for opportunistic funds to try and leverage their position, absent a cram-down mechanism. Furthermore, creditors are often unwilling to accept a haircut, unless they are sure that the debtor is indeed in financial difficulty, while the debtor may not be prepared to provide full financial insight. Creditors, on the other hand, may not be willing to spend cash on due diligence, when there is a possibility their claims are not going to be paid. A scheme outside of insolvency proceedings does not involve court approval, therefore no objective test is applied as to whether the situation is really as presented. Creditors may refuse to join the composition or debt rescheduling without loss of rights. It is not possible to force creditors to accept. Only in extraordinary circumstances will a refusal be considered wrongful. It would need to constitute an abuse of law or be contrary to the principles of reasonableness and fairness. This very rarely occurs. We note that there are legislative changes on the horizon that, if accepted, will result in creditor cram-down outside of bankruptcy.

Court-Based Insolvency

The two primary insolvency regimes under Dutch law are suspension of payment (“*surseance van betaling*”) and bankruptcy (“*faillissement*”). The first is intended to grant temporary relief from a debtor’s payment obligations and may be used to facilitate the reorganisation of a debtor’s obligations and enable the debtor to continue its business as a going concern. The latter is aimed at liquidation of the debtor’s assets and subsequent distribution among its creditors. There is also an emergency regulation for insolvent financial institutions, but this will not be discussed in this chapter.

Suspension of Payment

A (legal entity) debtor may file for suspension of payment itself (together with an attorney-at-law) by means of a petition to the district court in the district it is incorporated. The “test” is that the debtor foresees that it will not be able to pay its debts as they fall due (i.e. a liquidity test). The debtor must provide the court with several exhibits including, but not limited to, an overview showing its current assets and liabilities. The debtor may choose to include a draft creditor composition plan with its petition.

If the statutory conditions have been met, the court will immediately grant a provisional suspension of payment without evaluation of the merits. One or more administrators will be appointed to act alongside the authorised representatives of the company (its directors). An administrator is an independent third person (usually an attorney-at-law) that will periodically report on the status of the company. Unless creditors representing a certain amount of debt declare themselves against the final suspension, and provided that the court finds the existence of prospects that suggest in due course the debtor will be able to meet its obligations, the court may grant a final suspension of payment.

Consequences of Suspension of Payment

During the (provisional and final stages of a) suspension of payment regime, the unsecured creditors are barred from recovering their claims against the debtor's assets, and enforcement measures already taken are suspended by operation of law. Any attachments levied against the company are lifted. Suspension of payment therefore provides only a certain amount of breathing room. The questions of if and how the company will be able to survive are leading during the suspension of payment regime. If survival is not a realistic option, bankruptcy must subsequently be requested.

After the suspension of payment has been granted, the directors of the company no longer have the authority to represent the company on their own. The administrator also does not have this authority. Save for a few exceptions, the company can only be legally represented by both the directors *and* the administrator together.

Secured creditors and certain preferential creditors (such as tax and social security authorities) are generally excluded from the operation of the suspension of payment. This means that secured creditors having a right of pledge or mortgage on certain assets may enforce these rights seeking recourse for their claims. The same goes for certain preferential creditors. One or two other exceptions apply.

As in bankruptcy, a cooling-off period may be ordered. This will temporarily prevent even secured creditors or third parties whose property is located at the bankrupt company from enforcing their claims.

Composition

During the suspension of payment, the debtor may offer its unsecured and non-preferential creditors a composition. The DBA does not prescribe the contents of a scheme of arrangement. Usually, the debtor offers to pay a percentage of the claims against final settlement. The debtor may, however, offer a different type of scheme. For example, payment in instalments, payment through future profits, conversion of debt to equity, or simply an extension of payment terms. If many creditors are involved, the composition may include full payment of debts below a certain amount, as it may be considered too burdensome/costly to address all such (relatively) small creditors.

If a composition is offered, the court will convene a meeting of the unsecured, non-preferential creditors in order to allow them to vote on the draft composition. If a majority of the admitted creditors representing at least half of the total amount of the admitted claims, approve the composition, it is submitted to the court for approval.

Should the composition be rejected by the creditors, it may still be approved by the court on request, if three quarters of the admitted creditors that appeared at the meeting voted in favour of the composition and if the rejection of the composition was the result of creditors voting against the composition on unreasonable grounds.

The court will refuse the approval of the composition if:

- The assets (minus liabilities) of the estate considerably exceed the amount offered in the composition;
- The successful outcome of the composition is insufficiently guaranteed;
- The composition involves fraud, etc.;
- The fees and disbursements of the administrator and experts (who performed services for the administrator) are not taken into account; or
- An insolvency trustee opened main proceedings outside the Netherlands, unless the composition does not adversely affect the financial interests of the creditors in the principal proceedings.

The court may base its decision to refuse approval on other grounds as well. The decision of the court to approve the composition (or to refuse) is subject to appeal. Once approved, *all* creditors affected by the suspension of payment are bound by the composition.

End of Suspension of Payment

When all creditors have been satisfied in full, the suspension will end. If a composition is accepted by both the creditors and the court, the suspension of payment regime also ends and the unpaid portion of the creditor's claims is generally waived. A third manner in which the suspension of payment may end is by revocation followed by a bankruptcy.

Upon recommendation by the bankruptcy judge (if appointed) or upon request of an unsecured creditor or the administrator – for example in case of fraud by the directors or their unwillingness to cooperate with the administrator – the court may conclude that it is undesirable to continue the suspension in effect. It may also do so if it appears unlikely that the debtor will be able to satisfy its creditors in the course of time. The court may declare the company bankrupt in the same decision. Other, less frequented, grounds for revocation of the suspension of payment also exist.

Bankruptcy

Objective

Bankruptcy is aimed at liquidation and maximising recourse for the benefit of the joint creditors. The test is whether the debtor fails to make the payments to its creditors when they fall due (i.e. a liquidity test).

Formalities

A bankruptcy petition may be addressed to court by both the debtor itself and by (one of) its creditors. The latter is generally referred to as involuntary bankruptcy proceedings. Formally, the public prosecutor may also file for bankruptcy, although this rarely occurs. The competent court is the court in which district the company is incorporated. This court will declare the debtor bankrupt in cases where the debtor has ceased to pay its debts as they fall due.

Where a creditor petitions the court, it should demonstrate facts and circumstances constituting the plurality of creditors. This means that a sole creditor cannot file a petition without at least possessing knowledge of other creditors having unpaid debts. Note that these other creditors are not required to support the petition, although the courts are backtracking somewhat on this issue, since other creditors may be in support of restructuring discussions.

Where the debtor itself files for bankruptcy, it should attach various exhibits to the petition. Among the most important are the articles of association, a shareholder's resolution to petition the bankruptcy and an up-to-date overview of assets and liabilities evidencing the financial state of the company.

If the court grants the petition for bankruptcy and the debtor was not present at the hearing of the court handling the petition, it may file an opposition to the judgment with the court itself, possibly followed by an appeal against the decision regarding the opposition. If the debtor was present at the hearing, the bankruptcy ruling may be appealed before the Court of Appeal. A creditor whose petition for the bankruptcy of its debtor has been dismissed, directly or following opposition by the debtor, also has a right of appeal. The periods for appeal and opposition are short.

Consequences of the bankruptcy

The bankruptcy judgment generally has retroactive effect until midnight on the day it was rendered.

The "principle of fixation" results in an automatic general arrest over the debtor's assets. Unsecured creditors can no longer enforce their claims, but must submit these to the trustee. Attachments that have been levied against the company will be considered lifted, as the bankruptcy itself is considered an (almost) all-encompassing attachment on the assets of the bankrupt company.

To allow the trustee some time to gain insight into the situation without the estate being torn apart by various claiming parties, a cooling-off period may be ordered. This will temporarily prevent even

secured creditors or third parties whose property is located at the bankrupt company from enforcing their claims.

The court will appoint one or more bankruptcy trustees (an independent administrator: usually an attorney-at-law) that will work under the supervision of a bankruptcy judge. The debtors and creditors cannot choose who this trustee is, but a request can be made that an experienced trustee is appointed if the bankruptcy is complex. The trustee is required to periodically report to the judge. These reports are made available to the public and serve as a valuable – though sometimes somewhat outdated – source of information to the creditors.

The trustee is (solely) entrusted with the administration and liquidation of the bankrupt estate. The company's directors are no longer authorised to represent the company to the extent that the company's assets are affected. The trustee requires and has a right to information about the administration of the company and will make an inventory of assets. The trustee will usually sell off all assets and will aim at maximising the proceeds. He may terminate certain types of agreements (including employment and lease agreements: with short statutory notice periods). The trustee is also authorised to default on certain contractual obligations (to perform or tolerate) and cannot generally be forced to fulfil the debtor's obligations *vis-à-vis* its creditors. Alternatively, he may also decide to continue the business for a certain period of time, if such continuation is in the best interests of the combined creditors and stakeholders. Public interests may also play a role.

We note that the company's directors still have the obligation to file its annual accounts, even during suspension of payment or bankruptcy.

Restart (Purchase out of the Bankrupt Estate)

If the opportunity arises, a trustee will sell (part of) the debtor's business to an interested party. Usually higher revenue can be achieved by selling the business as a whole or in part by private treaty, than by organising a public auction to sell off all the individual assets. The trustee may conclude asset transactions, but will require permission from the bankruptcy judge. Such sales may, to a certain extent, be prepared prior to bankruptcy, possibly in cooperation with secured creditors such as banks, but the trustee is not compelled to sell to any one party (for instance to former management or a new company set up for his purpose). He may choose the party with the best proposal. Although his attention mainly remains with the combined creditors' interest (i.e. the highest bid), the trustee will recognise other (public) interests, such as continuation of employment, when considering proposals.

Registration of Claims

All claims, except secured claims or claims against the estate, must be filed for verification with the trustee. Unless the court has fixed a date for the claims validation meeting ("*verificatievergadering*"), there is usually no time limit within which claims must be filed (i.e. no standard claims filing date). Claims must be filed in writing and substantiated by proof. Prior to a claims validation meeting, the trustee will make a list of the claims he either provisionally admits or challenges. An online tool has been developed for creditors to submit their claims through a centralised process.

Claims against a bankrupt debtor can only be verified in euros. As a general rule, interests over any claim may only be verified insofar as they have fallen due prior to the bankruptcy date. When valuating financial instruments such as notes accelerated after the bankruptcy date, interest over the period following bankruptcy may to a certain extent still be taken into account. Depending on the financial instruments involved and the moment of acceleration, a discount may be applied to the valuation in order to arrive at the amount of the claim admitted for validation.

The court will only fix a date for the claims validation meeting if unsecured claims can be (partially) paid. In such cases, the court will also fix a date prior to which any claims must be filed. The period between these dates must be at least 14 days. At the claims validation meeting the trustee, the managing director(s) and the creditors will meet under the presidency of the court, in order to discuss all claims against the debtor. Each of them may contest the validity of any claim. If the court does not succeed in bringing the parties involved in contesting a claim to a settlement, the parties will be referred to a regular court procedure (claims validation proceedings), in which the competent chamber of the court will rule on the validity of the claim at stake. As soon as all claims are finally verified or referred to a court procedure, the trustee will deposit lists of the creditors at the office of the court

clerk. If these lists meet no opposition within 10 days after their deposit, they become irrevocable and binding.

If the estate does not have the means to pay (part) of the claims of the ordinary creditors, the trustee can request or the bankruptcy judge can decide that there will be no claims validation meeting. In that case, the trustee will simply wind up the business, liquidate the assets of the estate and terminate all pending matters, after which the bankruptcy will be terminated by the court due to a lack of assets. In such cases, no payment will be made to any unsecured, non-preferential creditor. The creditors known to the trustee will be informed of this.

Claim Ranking and Priorities

A leading principle of Dutch bankruptcy law is the *paritas creditorum*, which means that all creditors have an equal right to the debtor's assets and that the proceeds of the bankrupt estate are distributed among them *pro rata parte*. However, there are creditors to whom the principle of *paritas creditorum* does not apply:

- Creditors that hold a security interest; and
- Creditors that have a preference by virtue of law.

Therefore, the *paritas creditorum* applies to those who have an unsecured claim and do not have a right of preference, i.e. the ordinary creditors share *pro rata parte* in the amount available to them. A further exception can be made for subordinated claims.

Secured Creditors

The most important secured creditors are those who:

- Hold a mortgage; or
- Hold a pledge.

Creditors who hold a security interest may exclude the collateral from the debtor's estate and enforce their rights: the creditor is entitled to prompt foreclosure even if the debtor was adjudicated bankrupt. A secured creditor may therefore act as if there were no bankruptcy. The mortgagee and the pledgee are both entitled to auction off the collateral without the cooperation of the trustee; they are further entitled to deduct the sums owed by the bankrupt debtor from the proceeds of the auctioned property. The excess proceeds, if any, are then handed over to the trustee. An agreement may also be entered into with the bankruptcy trustee regarding a private sale, if the proceeds thereof are expected to at least equal the proceeds of an auction. The trustee may in fact arrange this private sale on behalf of the secured creditor, for which this creditor will generally pay a contribution to the estate.

The automatic stay of all actions against the debtor, which results from an adjudication of bankruptcy (fixation), does not apply to secured creditors. Note, however, that a secured creditor cannot remove any assets from the estate during a cooling-off period. Furthermore, the trustee is obligated to respect the interests of those with higher ranking claims. If there are insufficient unsecured and unencumbered assets in the estate to pay higher ranking creditors (e.g. certain tax claims and rights of retention), the trustee may claim (part of) the proceeds achieved by the secured creditors through the sale of secured assets.

The trustee is entitled at all times to have the collateral released from a mortgage or a pledge by paying the mortgagee or the pledgee the amount owed by the bankrupt debtor. If the amount the debtor owes to the mortgagee exceeds the principal sum specified in the mortgage, the trustee may release the property by paying the portion of the debt attributable to the mortgage. The mortgagee must then release the collateral from the mortgage.

The trustee is in principle not entitled to retain the encumbered property. If the secured creditor obtains payment of his claims by executing on the security, he will not be charged with bankruptcy costs. However, if the secured creditor does not enter into an agreement with the trustee regarding the sale of the assets concerned, nor make timely use of its enforcement rights, the trustee may sell

the assets concerned itself. In such case, the secured creditor will still have priority as to the proceeds, but it will need to share in the bankruptcy costs (which may well exceed the proceeds).

Creditors that have the right of ownership of personal property (e.g. through retention of title/reservation of ownership) also have a very strong position in bankruptcy, comparable to that of secured creditors.

Preferred Creditors

There are two categories of preferred creditors:

- Creditors who have a statutory priority; and
- Creditors who have a non-statutory priority.

Most preferred creditors are not entitled to initiate foreclosure proceedings. They are required to present their claims to the trustee and are charged their *pro rata* share of the costs of the bankruptcy.

Creditors with a Statutory Priority

Preferential rights are created by specific, limited statutory provisions only. These rights create a preference regarding the distribution of the proceeds of the liquidation. They may relate to all of the debtor's property or to specific property only. If the trustee recognises the preference, and unless another creditor has a higher priority, the preferred creditor will be the first to receive payment from the proceeds of the collateral. The creditor who has priority over the proceeds of goods delivered by him should notify the trustee of his preference. If the creditor fails to notify the trustee before the trustee sells the goods to which the preference relates, the creditor runs the risk that his preference will not be acknowledged.

The preferences of the tax and social security administrations are among the highest in rank. Even after an adjudication of bankruptcy, the tax administration has the right in certain circumstances to attach movable property located "on the premises" of the debtor. This may include the property of third parties and can be enforced even after an adjudication of bankruptcy (or a suspension of payment), but only as far as it relates to the property of third parties.

Creditors with Rights which Operate as Priority

Some creditors are in the position of having a right, which *de facto* operates as a priority. The main rights enabling the creditor to enforce such a "priority" are the right to retain property, retention of title, and the right of set-off.

The right to retain property is a statutory remedy available to certain types of creditors who may refuse to surrender possession of goods as long as the outstanding debt remains unpaid. An adjudication of bankruptcy does not affect the right of retention. For example, prior to being declared bankrupt, a debtor brings his car to the garage for repairs. Under Dutch law, the garage owner may be entitled to withhold the car until he is paid for the repair charges by the bankruptcy trustee.

Set-off is a means by which the debts between two parties are discharged through cross demands which cancel each other out. This right is governed by both the Dutch Civil Code and the DBA. The possibilities for set-off in bankruptcy are somewhat broader than outside of bankruptcy. For the right of set-off to be used in bankruptcy, both the claim and the debt must exist before the adjudication of bankruptcy, or must originate from acts performed prior to the bankruptcy.

Estate Creditors

Certain claims are regarded as "claims against the estate". They generally arise following an adjudication of bankruptcy and ensue from either statutory provisions or from actions by the trustee ("*toedoen*"). These claims have priority over other claims. Estate claims do not have to be submitted to the trustee for validation and are immediately enforceable against the estate, though in practice there is often a delay in payment, especially if it is uncertain whether there are sufficient assets to pay all estate creditors (in which case the trustee generally applies a ranking of estate claims). Examples of estate claims are:

- The costs and salary of the bankruptcy trustee;
- The costs of liquidation the estate;
- Claims ensuing from obligations that arise following the bankruptcy adjudication to the extent that the estate benefits from this;
- The wages of employees as of the date of the bankruptcy adjudication, for a maximum period of six weeks following dismissal by the trustee, including holidays not taken and the commutations of pensions;
- Lease or rent as of the date of the bankruptcy adjudication, for a maximum period of three months following termination of the lease agreement by the trustee;
- Claims that ensue from acts performed by the trustee, including agreements entered into by the trustee, but also claims that ensue as a result of omissions by the trustee.

Claims against the company that arise after the adjudication of bankruptcy and that are not considered estate claims generally cannot be validated and will not receive a share of the proceeds.

Unsecured Creditors

As explained above, the equality of all creditors ("*paritas creditorum*") is an underlying principle of Dutch bankruptcy law. It applies to all unsecured creditors that do not have any preference. They will only (partially) be paid if there are sufficient remaining proceeds after all other (preferred, estate, secured) creditors have received payment.

Composition

During the bankruptcy, the debtor may offer its unsecured creditors a composition. In such cases, the court will convene a meeting of unsecured creditors in order to vote on the draft composition. If a majority of the admitted unsecured creditors representing at least half of the total amount of claims approve the offer for a composition, it is submitted to the court for approval. All unsecured creditors are bound by such a court approval. Should the composition be rejected by the creditors, it may still be assumed approved on request, if three quarters of the recognised creditors that appeared at the meeting voted in favour of the composition and if the rejection of the composition was the result of creditors voting against the composition on unreasonable grounds.

The court will refuse the approval of the composition if:

- The assets (minus liabilities) of the estate considerably exceed the amount offered in the composition; or
- The successful outcome of the composition is insufficiently guaranteed; or
- The composition involves fraud, etc.; or
- An insolvency trustee opened main proceedings outside the Netherlands, unless the composition does not adversely affect the financial interests of the creditors in the principal proceedings.

The court may base its decision to refuse court approval on other grounds. The decision of the court to approve the composition (or to refuse) is subject to appeal.

Clawback and Recovery Mechanisms

A fundamental principle of Dutch law is that a debtor is free to dispose of its assets as it sees fit. There are, however, some restrictions to this freedom. If this disposal of assets is detrimental to the recourse possibilities of its creditors and is, furthermore, non-obligatory, Dutch civil law and bankruptcy law provide claw back and recovery possibilities, which are referred to as "*Actio Pauliana*". *Pauliana* inside and outside of bankruptcy provides the trustee/creditor(s) with the option to invoke the invalidity of certain legal acts. *Pauliana* has been accepted by Dutch courts under varied

circumstances, e.g. in cases of payment of debts, set-off, establishing of security and even the payment of dividends. The case law is extensive and at times complex.

Outside of bankruptcy, any and all disadvantaged creditors may invoke article 3:45 of the Dutch Civil Code. In bankruptcy, only the trustee has a right to invoke *pauliana*. He can do so on the basis of article 42 of the DBA and only for the benefit of the entire bankruptcy estate. Creditors may still file a claim against the debtor during bankruptcy on the basis of a wrongful act when fraudulent preference occurs, but the trustee's claim may be considered to take priority over such a claim. *Pauliana* can be invoked inside and outside of court. In the latter case a written statement must be provided to the parties concerned in which the *pauliana* is invoked.

In order for *pauliana* to apply:

- The legal act must be non-obligatory (not mandatory by law or contract);
- The legal act must have prejudiced the creditors (in bankruptcy the combined creditors; outside of bankruptcy one or more creditors); and
- If the legal act was performed in exchange for consideration, the creditor/trustee must prove that both the debtor and the other party knew that the act would prejudice the creditor at the time the legal act was performed.

If no consideration was concerned (e.g. a donation or payment well below the actual value), the creditor/trustee must only prove that the debtor knew he acted to the detriment of creditors in order for *pauliana* to be accepted at the time the legal act was performed.

Third parties may, under certain circumstances, remain unaffected by the *pauliana* if they acted in good faith and – if there was no consideration for the legal act – if the third party did not benefit in any way from the legal act at the time *pauliana* was invoked (outside of bankruptcy) or the bankruptcy was adjudicated (inside bankruptcy).

The knowledge that a legal act would prejudice the debtor's creditors is presumed by law for all transactions performed in case of bankruptcy: within one year of an adjudication of bankruptcy, and outside of bankruptcy: within one year of invoking *pauliana*, when it can also be established that the transaction meets the criteria of one of the following categories:

- Transactions in which the debtor received substantially less than the value that was given by the debtor;
- Payment of, or granting of security for, debts which are not yet due;
- Transactions entered into by the debtor-natural person with certain relatives;
- Transactions entered into by the debtor-corporation with its managing or supervisory director(s) or relatives to these directors or shareholders;
- Transactions by the debtor-corporation with another legal entity, provided that one of the involved entities is a director of the other, or that there are certain family ties between either the director-natural persons or the shareholder-natural persons of the involved entities; or
- Transactions by the debtor-corporation with a subsidiary or affiliate company.

Note that prejudice of the creditors may still be assumed present even if the balance sheet of the bankruptcy estate remains practically unaffected. For example, in case of a payment of debt, the assets on the balance sheet will decrease by the paid amount, but the liabilities (debts) will decrease by the same amount. On paper, there seems to be no disadvantage to the estate. However, this creditor is then paid in full, while the other creditors will only receive a pro rate share of the assets, which in bankruptcy often entails they will (at most) only receive part of their claim. This one creditor has therefore received an advantage to the detriment of the other creditors, who would otherwise

have received a share of the assets now used to pay that first creditor's claim in full. Case law provides guidance as to when this situation may apply.

The presumption of knowledge may be overcome by the debtor and/or other party by providing evidence to the contrary.

In bankruptcy, a debtor under a legal obligation to pay a certain creditor may still be confronted with *pauliana* if it is demonstrated by the trustee that the other party knew that a petition for bankruptcy was actually filed at the time of payment or if it is demonstrated that the legal act is a result of conspiracy between the debtor and the other party to defraud creditors. Once demonstrated, evidence to the contrary is no longer allowed.

In short, when faced with a debtor's financial difficulties, the risk of invalidity of any ensuing legal acts to safeguard payment must be taken in account.

Dutch tax, family and criminal law also contains several *pauliana* provisions that are not discussed further in this Guide.

Directors' Liability

Legislation and case law in relation to directors' personal liability is extensive.

Liability vis-à-vis Tax Authorities

If taxes and social security contributions are not paid, the tax authorities can hold the managing directors personally liable for the unpaid amounts if the company did not timely notify the tax authorities/social institutions regarding its incapability to pay the amounts due.

Internal Liability

Only a few managerial duties are described in Dutch law. An example is the standard of care that the director should observe towards the company. A director may be held liable by the company itself – or, in case of bankruptcy, by the trustee – for the damages suffered by that company when he acts contrary to his obligations and the damages are a result of that mismanagement. The director is obliged to perform to the best of his abilities in the interest of the company and as could be reasonably expected from a competent and qualified director under the same circumstances.

For liability to be accepted there must be a serious personal reproach/fault on the side of the director. All relevant facts and circumstances must be taken in account. Not every imperfection or mistake leads to liability: the director is granted a certain degree of latitude. In principle, collective responsibility entails that all directors are severally and jointly liable for failure, although individual directors do have the opportunity to exculpate themselves when held liable. For exculpation the director must show that he is not to blame for the mismanagement and that he has not been negligent in taking measures to avert the negative consequences of the mismanagement. The board of directors may also be discharged by the general meeting of shareholders, lifting the directors from (internal) liability with regard to the management in the period relevant to the discharge. The discharge only relates to the facts that are officially known to the general meeting.

An example of improper performance is entering into irresponsible financial transactions involving great financial risks. Another example of internal liability may apply when a director forces a company to lend a large amount to a third party without stipulating security and/or interest and the third party subsequently goes bankrupt.

Note that, since January 2013, the trustee can (also) request an investigation into mismanagement of the bankrupt entity before the Dutch Enterprise Chamber (a business court). The Dutch Enterprise Chamber may implement measures itself, although in bankruptcy – with an independent third party already appointed as trustee – the establishment of mismanagement generally leads to separate civil proceedings against the directors personally.

External Liability

Under Dutch law, each director is jointly and severally liable to the bankrupt estate for the amount of the obligations to the extent that these cannot be satisfied out of the liquidation of the assets, if the directors have apparently performed their duties in an improper way and it is plausible that this is an important cause of the bankruptcy.

A successful liability claim on this basis requires apparent mismanagement of the board of directors of the company and *prima facie* evidence that the apparent mismanagement was an important cause of bankruptcy. Hard and fast rules do not exist on what constitutes “apparent mismanagement”.

However, some legal presumptions apply: when the board of directors has not fulfilled either its obligations to maintain adequate administration of the company, or its obligations to timely publish the annual accounts and annual report of the company in accordance with legal requirements, there is by virtue of law:

- An irrefutable presumption of apparent mismanagement by the board of directors; and
- A refutable presumption that this apparent mismanagement was an important cause of the bankruptcy.

Only mismanagement performed during the period of three years preceding the bankruptcy is relevant for this type of claim. Note that the above may also be applicable to a person who is not a formal director but who is the decision maker within the company: a so-called “*de-facto* director” or pseudo director, such as a (director of a) dominant shareholder of the bankrupt company.

Wrongful Act

A third party – including the trustee on behalf of the bankrupt company – can hold a director liable if the director has committed a wrongful act. Most parties who hold a director liable on the basis of a wrongful act are unpaid creditors of the bankrupt company. For instance, a director can be liable for damages resulting from the default of the company to satisfy its obligations under an agreement, when the director at the time of entering into the transaction knew or reasonably should have understood that the company would not (or would not within a reasonable period of time) be able to satisfy its obligations or provide recourse for the damages resulting thereof for the creditor.

Conclusions and Additional Observations

Dutch insolvency legislation is based on generally accepted principles such as *paritas creditorum*. Although some of its provisions appear no longer fit to deal with highly complex financial issues, and although the DBA may well be criticised in other respects, it has done an adequate job for over a century. The reason for this may be that it allows room for development through jurisprudence. The case law is extensive and insolvency issues are therefore often complex. This guide can therefore only provide a high-level review.

Fraud and Funding in Insolvency Proceedings

The court-appointed trustee is paid out of the proceeds of liquidation of the bankrupt estate. In most cases, these proceeds are too little to pay the trustee’s fees, let alone the claims of any creditors. Some believe this system paves the way for abuse: in cases in which directors understand that are guilty of mismanagement, they often know it is beneficial to completely empty the company, leaving no means available for paying the trustee’s bill. In such cases, the trustee is unlikely to be inclined to conduct a (costly) full-blown investigation into the company’s affairs and may terminate the bankruptcy with only superficial attention and effort, providing the directors with a get-out-of-jail-free card. Trustees report fraud to the authorities in only a minor percentage of cases. Although some government funding can be requested to chase fraudulent directors, the formal requirements are of such an unappealing nature that trustees often forsake that route.

In recent years, fraud in bankruptcy has increasingly attracted the government’s attention and it can now be considered a prime concern. Comprehensive policies to act more forcefully against it have been announced and partially implemented. The sanctions and tools granted to the bankruptcy trustee and the public prosecutor in civil and criminal law will be expanded and will include, among

other aspects, director disqualification for a maximum of five years in case of mismanagement. Trustees are also actively encouraged to report on fraud and may soon be given the legal obligation to investigate fraud. We expect to see start seeing changes in enforcement against bankruptcy fraud in the relatively short term.

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