Forced cooperation on a debt for equity swap; (im)possible?

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I. Introduction

If a company gets into financial difficulties, it may be desired to proceed to financial restructuring of the company in such a way that part of the company's outstanding debt is converted into equity (the so-called debt for equity swap, i.e., converting a creditor's claim on a company into a shareholder's interest in that company).

In elaborating on such restructuring process, the question arises if, and if yes, how a bondholder, member of a syndicated finance or shareholder obstructing such a restructuring process can be forced to cooperate. In the present article, the ins and outs of this question are answered according to Dutch law, following (consecutive) discussion of the present financial and economic crisis, the need of restructuring by companies and the economic reality of financial restructuring.

II. The crisis

1. As from the second half of 2007, (the financial and then) the economic crisis has been raving around the world. What started as a problem with subprime mortgages in the United States, soon turned into a financial tsunami[2] spreading all over the world. Much has been said (and will be said) about the crisis, also in the Dutch legal literature.[3] Within the framework of this article, I wish to restrict myself to a number of elements which are relevant to illustrate my argument.[4]
2. The economic cycle is a given and essentially no more or less than the economy's biorhythm. Part of this cycle are the so-called economic bubbles which Geert Noels identifies as periods of collective madness in his splendid book Econoshock.[5] Bubbles denote a (temporary) increase in economic activity accompanied by financial speculation. A well-known example of a bubble is the famous Tulip mania from the period 1623-1637 when the prices of tulips rocketed.[6] Bubbles have a self-propelling effect as a result of the so-called *positive feedback loop,* caused by the universal human tendency to follow the herd. Perceiving increase in value and observing that others benefit from this value increase, causes a general desire among people to get their share and participate.

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[2] On 14 February 2008, the New York State Governor, Eliot Spitzer used this phrase in his statement before the Committee on Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises United States House of Representatives (see http://financialservices.house.gov/hearing110/spitzer021408.pdf). One week earlier, a CEO of Deutsche Bank used the same phrase, see Financial Times 8 February 2008
[3] See, for example, Reinout Vriesendorp and Reinout Wibier in *NJB* [Netherlands Law Journal] 2009, issue 1, pp. 2 et seq., about the credit crisis and private law in which they discus the role of securitisation in the credit crisis. See also Reinout Wibier in *NJB* 2009, issue 19, p. 1198 in which he discusses the lessons to be learned from the credit crisis with reference to the so-called Turner review by Lord Turner, the Chairman of the UK Financial Services Authority (full text at: http://www.fsa.gov.uk/pubs/other/turner_review.pdf). See also the theme issue about the credit crisis of *Ondernemingsrecht* [Netherlands Company Law Journal] 2009-14 which discusses the credit crisis from various angles. See also the collected *De Kredietcrisis* [the Credit Crisis] in the *Serie Onderneming en Recht* [Company and Law Series], part 54.
[4] Cf. www.legalhoudini.nl for a number of other sources and locations. For an elementary and legible overview of the crisis, I recommend the book Crisis Economics, a crash course in the future of finance by Nouriel Roubini and Stephen Miller (2010). Dr Doom, as Roubini, a NY Stern professor, is also called, at one point predicted the credit crisis.
[5] Geert Noels, Econoshock (2008), pp. 22 et seq.
[6] Anne Goldgar, Tulipmania: Money, Honor, and Knowledge in the Dutch Golden Age (2007)

Robert Shiller refers to this as "naturally occurring Ponzi processes".[7] Demand is growing faster than the offer causing an increase in price. This *positive feedback loop*, for that matter, is also used by fraudsters deploying Ponzi schemes (exclusively, or at least, mainly) for their own benefit. They lure people with returns that are too good to be true, but because the sum paid in by each new investor, is used to pay this overly high return to another investor, it all goes well as long as new investors are found.[8] The biggest fraud – up to now – using this technique is the Madoff fraud[9]. Of course, Ponzi schemes must be clearly set apart from economic bubbles; in the case of a real Ponzi scheme the value – almost – entirely consists of hot air, whereas in the case of a bubble the existing value is pumped up to a fictitious (overly) high level, which nonetheless is based on a real underlying value. As a result of a crisis, the air escapes from the bubble and the value returns to "standard" level. In this respect, it can be noted that before the value returns to "standard" level, it usually drops below this level first. Just like the increase in the bubble is a self-enforcing process, the decrease of value in a crisis is accompanied by a similar effect, albeit in reversed direction (the *negative feedback loop*).[10]

3. How does the theory of the economic bubbles apply to the current crisis? Now, in the year 2010, it is a generally known fact that the current crisis was triggered by the bursting of the bubble of the United States housing market. Succinctly put, this bubble was caused by providing finance for the purchase of houses to people who should not have been able to acquire these loans under normal circumstances. However, because the buyers and their financiers knew (or rather: assumed) that the prices of houses would go up and that at the end of the loan, the old loan would be followed by a new loan which would be cheaper (because the value of the house had increased in the meantime), nobody worried. On the contrary, these so-called flippers did not buy these houses (almost exclusively financed with debt) to live in but exclusively with the objective of quick resale at high profits. Overly low interest rates and the search of investors after financial products with higher returns functioned as a catalyst. For a description of the American financial commotion, I refer to the books of Robert J. Shiller and Mark Zandi[11] which exemplify the path from individual subprime mortgage to investors worldwide. In 2009, Anne Katherine Barnett-Hart graduated from Harvard with her thesis: "the story of the CDO Market Meltdown". In this thesis, she neatly describes how subprime mortgages were used as a component of CDOs (compositions of various securitisations) and of CDOs squared (securitisations of securitisations) and later of CDOs-cubed even.[12] All of these products found their way to the shadow banking system[13] which provided sufficient

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[7] Robert J. Shiller in Irrational Exuberance (2nd edition 2005), p. 56.

[8] For a nice description of Ponzi swindles, see Frans Roest and Rogier Stijen in *Beleggen in gebakken lucht* [Investing in Hot Air (2009), pp. 29 et seq.

[9] The Ponzi Scheme by Madoff is good for a perpetual stream of publications of varying interest; for a discussion of a number of these publications, see www.legalhoudini.nl.

[10] Robert J. Shiller in Irrational Exuberance (2nd edition 2005), p. 71

[11] Robert J. Shiller in the Subprime solution (2008) and Mark Zandi in Financial Shock (2009) (see pp. 59 et seq. for the definition of flippers)

[12] See the online version of the Wall Street Journal of 15 March 2010, Michael Lewis' 'The Big Short'? Read the Harvard Thesis Instead! With a link to the thesis. Partly on the basis of this thesis, Michael Lewis wrote his book The Big Short (2010). In respect of securitisations, see also Reinout Vriesendorp and Reinout Wibier in *NJB* 2009, issue 1, pp. 5 et seq. but also and in particular the clear explanation of Mark Zandi in Financial Shock (2009), pp. 117 et seq., the Financial Alphabet Soup. See for a very extensive and highly technical explanation of the terms, Gary Gorton in the Panic of 2007, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1255362 (meanwhile published as part of a book) : Gary Gorton, Slapped by the invisible hand, the Panic of 2007 (2010). Insofar as the above may lead readers to believe that I am against (all forms of) securitisations, this concerns a – serious - misinterpretation. There is nothing wrong with securitisation, provided it is effected correctly, i.e., in a clear and transparent manner. In my opinion, Vriesendorp and Wibier have expressed this adequately.

[13] See for a description of the shadow banking system, for example, Gary Gorton in Slapped in the face by the invisible hand: Banking and the Panic of 2007, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1401882 (as also referred to above under note 12) .

cash facilities, not only in the United States, but as a result of globalisation, also in Europe and the Far East. Debt was available for – almost – anybody who needed it, everywhere and at low cost.

4. This low-cost debt also found its way to companies seeing because deployment of the well-known leverage effect provided the possibility to reinforce the profitability of the equity capital. Moreover, the more debt there is, the greater the leverage. The debt attracted by companies not only kept increasing, the structures used by these companies for attracting debt also became increasingly complex. Whereas financing with debt used to be comprised of a combination of collateralized bank obligations and unsecured claims of other creditors, this is now done through very complex structures and layers of both secured and unsecured claims. In addition, these claims are held by various parties.
5. Illustrative for the accumulation of debt are the excrescences[14] occurring in a number of so-called leveraged finance deals which were refinanced a number of times, each time at a higher costs and with a relatively larger share of debt. In his book, the Trillion Dollar Meltdown, Charles Morris describes this process as follows: "In effect, they've built a huge Yertle the Turtle–like unstable tower of debt by selling it back and forth *among themselves*, booking profits all the way. That is the definition of a Ponzi game. So long as free-money regime forestalled defaults, the tower might wobble, but stayed erect. But small disturbances can bring the whole tower down, and the seismic rumblings already in evidence portend disturbances that are very large".[15]
6. And then the bubble burst because the balance was disturbed by an increase in interest rates in the United States, arrears in payment on the subprime loans and the decrease of house prices.[16] The tower of credit started wobbling in the first half of 2007 and collapsed like a card house in the second half of 2007, the "Panic of 2007".[17] This collapse reached its provisional climax after the fall of the Lehman Brothers Bank in 2008.[18]
7. (Re)financing companies with debt became more difficult, more expensive and in some cases even impossible.[19] Instead of a surplus, there now was a shortfall of debt. The economic crisis following the credit crisis weakened the position of companies even more. Regarding the question as to when we have really reached the bottom, opinions differ. In "This Time is different". Reinhart and Rogoff describe eight centuries of financial folly and conclude that a banking crisis is often followed by a crisis in public finance.[20] The current problems in the Eurozone caused by the debts of Greece in particular give

[14] In this respect, it also applies that there is nothing necessarily wrong with leveraged finance as such, cf. the positive effects of buyouts, and the related debt, e.g. in: *Economische en sociale effecten van buyouts in Nederland* [Economic and social effects of buyout in the Netherlands], at http://www.nvp.nl/feiten/economisch.php

[15] Charles R. Morris, the Trillion Dollar Meltdown, p. 135 (2008), the second edition was published in 2009 with the title the Two Trillion Dollar Meltdown. Yertle the Turtle is a story by Theodoor Geisel about a turtle king ordering his subordinates to build a tower which becomes higher and higher, and consists of stacked turtles. However, the tower is unstable, collapses and king turtle falls into the mud. http://en.wikipedia.org/wiki/Yertle_the_Turtle_and_Other_Stories

[16] For two practical books respectively using a question & answer format, and diagrams, discussing the causes and consequences of the crisis in plain language, see: *Hoe overleef ik de kredietcrisis* [How do I survive the credit crisis], Willem Middelkoop (2009) and *Uitgekleed, hoe onze welvaart verdween* [Stripped off, how our wealth disappeared], Eduard Bomhoff (2009)

[17] Again, see Gary Gorton (note 12) who explains how the subprime problems eventually resulted in the crisis.

[18] About the developments resulting in the collapse of Lehman in 2008, Andrew Ross Sorkin wrote an accessible book in the style of a novel, Too big to fail, inside the battle to save Wall Street (2009). For a first-hand account of the fall of Lehman itself, see A colossal failure of common sense by Larry Mc Donald (2009). In this book, Mc Donald describes the fall of Lehman from the inside.

[19] See Victoria Ivashina and David Scharfstein in Bank Lending during the Financial Crisis of 2008 for an account of the state of affairs in the United States in respect of limitations of credit, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297337

[20] This Time is different, eight centuries of financial folly, Carmen M. Reinhart & Kenneth S. Rogoff (2009)

rise to suspect the worst in this regard. Or in other words, the end may not be in sight just yet.[21]

III. Necessity of corporate restructuring[22]

8. Companies which are confronted with (the prospect of) a crisis as a result of financing difficulties and/or a reduction in demand, are required to ask themselves the following question: Can we survive the crisis and if so, how? In order to assess the chances of survival, it is necessary to analyse the existing problems. In doing so, it is required to distinguish the symptoms from the causes of the difficulties.[23] The analysis must focus on detecting and solving the causes, thereby distinguishing between internal and external causes. Examples of internal causes include bad management, inadequate financial monitoring, bad operating capital management, high costs, insufficient marketing effort, overambitious and uncontrollable projects, failed takeovers, poor financial policy and improper functioning of the organisation. Examples of external causes include: changes in the market on which the company is active (including the credit market), the competitive position of a company and a sudden change in prices.

IV. Economic reality of restructuring

9. Once the company analysis has been made, the question arises as to what can and/or must be done. In some cases, the conclusion must be that there is no way out anymore. In that case, the company has reached the end of its economic life cycle and must disappear. A liquidation (either by means of a bankruptcy or otherwise) then is the appropriate solution. At the other side of the spectrum, there (sometimes) is the possibility of refraining from taking any immediate action. In the recent literature, this has also been described as "Extend and pretend".[24] There are no acute liquidity problems and we are hoping for better times. The financing structure of the company remains intact, the current financing facilities are extended. Such a response is usually only possible if the going concern value of the company in question is at least equal to all interest-bearing liabilities of the company. However, under certain conditions some creditors may even be prepared to continue the financing if this is not the case. These creditors realise that the alternative is the company's liquidation which comes with an additional value loss. In that case, they know that a substantial part of their claims will be lost. After all, there usually is a big difference between the liquidation value and the going concern value of the company's assets. This is the reason why creditors have an interest in maintaining the company's going concern status (assuming that there is a viable future for the company). However, in exchange for continuing their financing in such case – and all the more so in the case of continuing the financing when the going concern value of the assets is less than the total of liabilities, and the company thus has a negative equity position – the creditors usually demand a rearrangement of the current claims of some creditors and shareholders by means of renouncing part of these claims and/or converting claims into shares.

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[21] For those in command of the French language, Flore Vasseur wrote an amusing novel with a theoretical ending of capitalism, comment j'ai liquidé la siècle (2010) in which she describes how the capitalist system is ended by a bug in our computer systems.

[22] Restructuring of companies is also referred to as turnaround management, cf. for an introduction to this subject, part 14 in the series *Praktijkboek insolventierecht* [Practice Book Insolvency Law], Turnaround Management by J.A.A. Adriaanse (2006)

[23] See Corporate Turnaround, Managing Companies in Distress by Stuart Slatter & David Lovett (1999), pp. 13 et seq.

[24] Barney Whiter, Valuation Disputes in Restructuring, International Corporate Rescue, 2010, issue 1, p. 3.

10. In order to assess which creditors must give up which legal claims or parts thereof, it is required to evaluate the economic value of their relative claims in proportion to the value of the company (considering their preference, if any, on (certain) assets and any subordinations[25]). To this end, the so-called "enterprise value free of debt"[26] is established first. Subsequently, this valuation (and the creditors' preferential position, if any) is used to consider which creditors could still get (part of) their money back upon going concern sale of the company, and which creditors could not (or at least not entirely). The question to be answered in this respect is: "where breaks the value", which refers to the turnaround point at which shareholders or creditors are no longer able to get (part or all of) their money back. Insofar as the creditor can get (all or part of) his money back, the creditor is regarded to be (wholly or partly) "in the money". Insofar as – based on the valuation made – the creditor cannot obtain full or partial settlement of his claim, this creditor is (wholly or partly) "out the money". As long as the going concern valuation of the company turns out lower than the total of all liabilities, the shareholder also is fully "out the money".[27] This, for that matter, shows that economic reality often precedes legal reality. In the situation that a certain creditor cannot expect to receive any payment from his debtor's bankruptcy, his position is identical to that of the shareholder; they both have no prospect of payment.
11. The process of determining the value of the company is a matter of much discussion. It is justified to expect that this discussion will also be the hinge point of any future restructurings. Valuation is all but a mathematical science and a valuation comprises many "soft" opinions and evaluations of the future[28]. Moreover, values are – as already explained in the above – all but stabile over time. The valuation discussion will therefore always be fierce and important. Or to put in the words of Whiter: "With high stakes and with the volatility in asset prices, the question of 'where does the value break?' will increasingly be subject to dispute – either inside or outside of a court process'.[29] And where there is debate, there are lawyers attempting to secure particular positions in the discussion.[30]
12. As soon as the company's enterprise value free of debt and the relative position of all creditors and shareholders have been determined, it is time to consider the legal operation according to which the rearrangement of legal claims can be realised.

V. Restructuring without suspension of payments or bankruptcy

[25] For classes of creditors, see: A. van Hees in the *Bewindvoerder, een Octopus* [Administrator, an Octopus], issue *Serie Onderneming en Recht* part 44, pp. 543 et seq. In this respect, I wish to note that modern structured finance has considerably expanded the spectrum of – particularly, preferential – creditors, for instance, by means of establishing contractual regulations determining various debt layers. See in this regard Lachlan Edwards in IFLR April 2007, for an illustration of these layers, see S. Timmerman, Second Lien Loans in TOP 2007, no. 5, pp. 218 et seq.

[26] In respect of valuations of distressed companies, see Alistair Beveridge, Paul Hemming and Graeme Smith, Valuation of distressed business, Restructuring and Workouts (2008), pp. 75 et seq. and Michael Crystal QC and Rizwaan Jameel Mokal, the Valuation of Distressed Companies: A Conceptual Framework, Part I and I in International Corporate Rescue, 2006, issue 2 and 3

[27] I became familiar with the terms in and out the money when first dealing with options, see in this regard http://www.weekopties.nl/optietheorie.html

[28] In the financial world, the book the Black Swan (2007) by Nassim Nicholas Taleb is commonly known. Taleb describes the impact of unlikely events on the future. In other words: It is tough to make predictions, especially about the future, in respect of this quote, see, for instance, Paul Krugman (Economics Nobel Prize winner 2008) in the New York Times of 1 December 2006, Economic Storm Signals.

[29] Barney Whiter, Valuation Disputes in Restructurings: more to Come, International Corporate Rescue, 2010, issue 1, p. 6

[30] So lawyers can rest assured: no matter what state the economy is in, there will always be work in their line of business. Or to put it in banking terms: the flexible lawyer who has a way both with (the financing of) takeovers of companies and the restructuring of (the financing of) companies, has created a hedge for himself against the risk of economic fluctuations.

13. Theoretically, the restructuring should be carried out in such a way that only those in the money after the restructuring still have legal claims on the company. It may be clear that the circumstances at hand may vary a great deal. It is possible that – in the case of shares with a certain preference upon liquidation – some shareholders – the ordinary shareholders – are out the money whereas the holders of preferential shares and the creditors are not. Another scenario is that the shareholders are still in the money but that the creditors are of the opinion that continued financing on their part requires new equity in view of the perceived risk of the company. It is also possible that shareholders are out the money and all creditors (only just) in the money. Another possibility is that senior creditors are in the money, whereas others, the junior creditors, are not.
14. Financial restructuring without judicial intervention requires – apart from a special contractual regulation – the agreement of all interested parties demanded to make a sacrifice. To this end, intensive negotiations often involving give and take are necessary. It is my experience that in many cases, the objective is a straightforward 100% consensus between (only) the (shareholders of the) company and the *financial creditors* (succinctly put: bondholders and lenders in the case of syndicated loans) and consequently, not with the other creditors who continue to hold their original claims. This implies a deviation from exact legal priority, such to the detriment of the financial creditors. In this way, it is possible to carry out an informal reorganisation without the consensus of all the company's creditors being required. If the economic burden of this informal reorganisation is borne by the shareholders and the financial creditors, there is no reason to object to this.[31] Please note that in this restructuring process the financial creditors often take it for granted that other creditors continue to hold 100% of their claims, while (many of) these other creditors are plain competitors who would not get anything at all in the case of a bankruptcy because the financial creditors rank prior to them in respect of the proceeds of the assets. The financial creditors agree to this course of affairs because they expect to be better off this way than in the case of a bankruptcy and/or liquidation scenario.[32]
15. Economic scientific research shows that an informal reorganisation, i.e., a reorganisation effected without formal insolvency proceedings, is preferred over judicial insolvency proceedings.[33] There is less capital destruction, less debts remain unpaid and a higher rate of employment is maintained.[34] Moreover, the costs often turn out be considerably lower that the costs involved in formal legal proceedings.[35] Especially in the United States, there has been extensive research into the costs of hiring reorganisation consultants. On the basis of research conducted as early as 1991, Stuart Gilson already

[31] For recent opinions of the (legal department of) IMF on restructurings, cf.: IMF Staff position paper, Approaches to Corporate Debt Restructuring in the Wake of Financial Crises, at http://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf; The Netherlands also has contributed to this paper, see the acknowledgments made to Sijmen de Ranitz, ex De Brauw, currently RESOR.

[32] These forms of financial reorganisation usually do not relate to restructuring the number of staff; in this respect the Netherlands – as commonly known – has to deal with the problem of the often prohibitive costs of dismissing staff for a restructuring process outside of bankruptcy.

[33] Within the framework of this article, I will not go into the problem present under Dutch law, i.e., that separatists are not bound to an agreement in insolvency proceedings so that this offers no solution under Dutch law, cf. F.M.J. Verstijlen, the insolvency agreement in the collected *Voorontwerp Insolventiewet nader beschouwd* [Preliminary Draft Insolvency Act upon closer examination] (2008), pp. 129 et seq. The Insolvency Act Committee also acknowledged this in her last letter, which can be found on the blog of Bob Wessels at http://bobwessels.nl/wordpress/?p=646, cf. point 12, p. 16.

[34] *Het economisch belang van een doorstart: een informele reorganisatie heeft verre de voorkeur* [The economic importance of a new start: an informal reorganisation is highly preferred], B.P.A. Santen en A. de Bos in Insolad collected 2008 *Doorstart* [New Start], pp. 1 et seq.

[35] See, for example: J.A.A. Adriaanse and J.G. Kuijl, *Informele Reorganisaties in Nederland* [Informal Reorganisations in the Netherlands] in *Insolventierecht* [Insolvency Law] magazine 2004, issue 6. in particular the references to the literature under note 22 of the article.

reached the conclusion that the costs of hiring consultancy services (financial and legal) in the case of extrajudicial procedures were significantly lower than in the case of formal insolvency proceedings.[36] Martin J. Whitman and Fernando Diz give a nice overview of a survey into the costs in 2003 and 2004 and also reach the conclusion that restructuring without formal insolvency proceedings is much cheaper. A way of keeping a lid on the costs of formal insolvency proceedings is the so-called process of pre-packaging, i.e., finalising a restructuring process which has been prepared informally, by means of brief insolvency proceedings.[37]

16. However, what to do when it turns out impossible to reach 100% consensus between the debtor and the financials creditors? In this article, I focus on the situation in which the objective is to proceed to the restructuring of a company carried on (among others) by legal persons in the Netherlands. This often relates to Dutch (intermediate) holding companies which have shares in both national and international legal persons. This article discusses the objective of effecting a financial restructuring at (one or more) of these legal persons established in the Netherlands in respect of the claims of – only - the financial creditors without this legal person going bankrupt or being granted suspension of payments, and requiring a partial conversion of debt into shares. The shares of the Dutch (intermediate) holding company are encumbered with a right of pledge for the benefit of the lenders of a syndicated loan. The article assesses whether, and if so, how the shareholders of the legal person, the bondholders and the syndicate members can be forced to agree to the desired debt for equity swap. To that end, I will start with discussing the position of the bondholders, followed by the position of the banking syndicate and concluded by the position of the shareholders.

VI. Collective Action Clauses

17. How can we force an individual creditor to cooperate on the debt for equity swap? In answering this question, we can refer to the rules of the game for creditors of national governments.[38] A country cannot (according to current legal standards and in connection with the immunity of jurisdiction[39]) be declared bankrupt. In an economic sense, a country can stop making payments.[40] The consequence of this is that the only way to proceed to a restructuring of the country's debts is an extrajudicial agreement with the consensus of all creditors demanded to make a sacrifice. The IMF has been engaged in finding solutions for this so-called "all lenders consent" problem for some time. The IMF, for instance, launched a "sovereign debt restructuring mechanism". The idea was to prepare legislation at international level enabling states to proceed to restructuring

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[36] Stuart C. Gilson. Managing Default: Some evidence on how firms choose between workouts and chapter 11, also found in Corporate Bankruptcy, Economic and Legal Perspective, Edited by Jagdeep S. Bhandari and Lawrence A. Weiss, p. 308 (1996).

[37] Martin J. Whitman and Fernando Diz, Distress Investing (2009), pp. 53 et seq. Interesting – and for lawyers a little lesson in modesty – is their finding that lawyers actually destroy value (or at least, make too many costs) in Chapter 11 proceedings. In fact, they demonstrated a direct relationship between the number of law firms involved in Chapter 11 proceedings and the duration and costs of the proceedings (see page 68). I also regularly witness that our colleagues are not functioning as grease in the transaction, but rather consistently put sand in the machine. This, for that matter, applies to both informal and formal restructurings. In formal restructuring processes, the liquidators tend to lose sight of the fact that they should eventually be acting exclusively in the interest of the creditors, preserve as much value as possible and distribute this value in a correct manner according to the Bankruptcy Act.

[38] Cross-Border Debt Restructuring (2005), Esteban C. Buljevich, p. 3

[39] See for a more extensive and critical account: Bob Wessels in *Wessels-Insolventierecht* I [Wessels Insolvency Law], par. 1133

[40] Cf. the moratorium declared by Russia itself in 1998 on the debts of Russia in rouble, which eventually led to the fall of Long-Term Capital Management, as described by Roger Lowenstein in When genius failed, the rise and fall of fall of Long-Term Capital Management (2000)

processes on the basis of majority resolutions of creditors.[41] Gray states that pressure of market parties has made the IMF abandon this idea and look for the solution in stimulating contractual regulations, so-called "collective action clauses", in respect of government issued bonds.[42] These clauses contain the arrangement between the creditors to the effect that any resolution about restructuring does not require the agreement of all creditors involved in the arrangement, but only a predetermined majority (qualified or not).

18. If and insofar as the contracts with all financial creditors contain collective action clauses, it is possible to proceed to an informal reorganisation with the consent of each creditor individually. In that case, a resolution passed with the quorum agreed on with the creditors beforehand, could suffice to obtain approval of the financial creditors for a debt for equity swap.[43]

VII. Bonds and collective action clauses

19. Under Dutch law, such collective action arrangements are seldom found in contracts with creditors of companies. However, one does come across these arrangements in respect of bonds issued under Dutch law[44]. Botter in this respect with good reason points out the differences between the conditions attached to bond issue, thus requiring careful investigation which, in turn, means that "lawyers' paradise" is around the corner.[45] With this possibility of collective action, The Netherlands has another approach than the United States where as a result of the Trust Indenture Act, it is prohibited– succinctly put[46] – to modify the principal sum payment obligation or interest payments on a bond loan without the permission of the individual bondholder. And although this US Act has been criticised for being rigid and outdated, it still is in force. Consequently, the Act poses a complicated puzzle when it comes to international restructuring processes. It is an established fact that American bankruptcy proceedings break the provisions of the Trust Indenture Act, thus making it possible to restructure bonds issued under US law. In practice, one often sees that non-US issuing institutions wish to partake in the capital market of the United States. The legal persons GTS, Versatel and UPC with their registered offices in the Netherlands issued bonds under US law. When the dot.com crisis required restructuring of these bonds in the Netherlands, it was not possible to use

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[41] A new approach to sovereign debt restructuring, Anne O. Krueger (2002)

[42] Collective Action Clauses, the way forward, Robert Gray (2004), see also: IMF Continues Discussion on Collective Action Clauses in Sovereign Bond Contracts, http://www.imf.org/external/np/sec/pn/2003/pn0353.htm

[43] Even more far-reaching – for financial institutions – is the recent proposal of the Bank for International Settlements (BIS) pursuant to which certain financial instruments issued by a bank are automatically converted into shares or expire under particular conditions. So, in this manner, the prior consent, i.e., consent upon entering into the agreement pursuant to which the creditor acquires the instrument, of the creditors for this conversion is acquired. see http://www.bis.org/publ/bcbs174.htm

[44] See, for instance, the SNS base prospectus 2009, p. 35 under Modifications, Waivers and substitution: "The conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority." Also see the passages included in the ING Covered Bond Programme 2009, the ABN Covered Bond Programme update 2010, Fortis Covered Bond Prospectus 2009 and NIBC Covered Bond Programme Update 2009, at all instances under Meetings of Covered Bondholders, modification and waivers.

[45] R.J. Botter, *Herstructurering van door Nederlandse uitgevende instellingen uitgegeven obligaties* [Restructuring of bonds issued by Dutch issuing authorities], in Anniversary edition 2002 *Vereniging voor Effectenrecht* [Association for Securities Law], p. 39.

[46] See George W. Shuster, Jr, The trust indenture act and international debt restructurings, in American Bank Institute Law Review (2006), Vol 14:431, pp. 431 et seq. for more details; also see Galvis and Saad, Collective Action Clauses: Recent Progress and Challenges Ahead about exemptions, the text of the regulation is available on the SEC website: http://www.sec.gov/about/laws/tia39.pdf

the regime applicable to bonds issued under Dutch law (which often do contain a collective action clause), but the US law governing the bonds had to be applied.[47]

20. Bonds governed by Dutch law often are subject to collective action clauses. In those cases, a resolution passed by the majority of bond holders will suffice for a debt for equity swap. Tollenaar refers to (old[48]) judge-made law in the Netherlands which in so many words states that in the Netherlands it is possible to effect a conversion of bonds into shares against the will of the minority of bondholders.[49]

VIII. Syndicated loans and the absence of collective action clauses

21. Nowadays, companies often find finance by means of syndicated loans. A syndicated loan is a form of financing pursuant to which a number of lenders issue loans to one or more borrowers under the same conditions. The terms of financing are laid down in a syndicated loan agreement whereby the loans of individual lenders are separate loans which are provided – sometimes with the exception of the principal sum - under the same conditions.[50] In view of the fact that the lenders have furnished individual loans, they also have independent claims on the borrowers. The way in which they can exercise their rights in relation to these claims, has been laid down in a syndicated loan agreement. Insofar as various layers of debt (Senior, Junior) are distinguished, there are usually separate loan agreements for each layer of debt and the relationship between the borrowers and creditors is mutually laid down in a so-called intercreditor agreement. Syndicated loans for larger companies as encountered in Dutch financing practice are, for that matter, often governed by UK law, also if the debtor is a legal person with its registered office in the Netherlands.
22. It is not common for syndicated loans to include the above-mentioned collective action clauses which make it possible to convert (part of) the debt in shares without the consent of all syndicate members. On the contrary, the common provisions require “all lenders consent”. According to Kent, the Bank of England urged UK banks to accept the action clauses, but to no avail.[51] It also my experience that Dutch banks attach value to their individual powers of blocking a restructuring process. I believe that their most commonly used argument in this regard, i.e., that they wish to stay in control, is – especially in the case of syndicates with a large number of members – a fake argument. After all, how much control can one exercise over a process when seated as a single member in a syndicate of 30 members requiring each other member to vote in favour also?[52]
23. Gray has given two arguments for non-application of collective action clauses in syndicated bank loans.[53] The first argument relates to the alleged large degree of

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[47] See for an extensive account of this subject: P.R.W. Schaink, *Surseance als vehikel voor debt-for-equity swaps* [Suspension of payments as a vehicle for debt-for-equity swaps], *Ondernemingsrecht* [Company Law] 2003-05, p.173 and R.J. van Galen, *Homologatie UPC-akkoord* [Homologation UPC agreement], *Ondernemingsrecht* 2004-03, p. 95;

[48] In view of the data gathered between 1936 and 1940, it apparently concerned the consequences for companies brought about by the Great Depression of the 1930s.

[49] N.W.A. Tollenaar, Debt for Equity Swaps, in *De Bewindvoerder, een Octopus*, issue *Serie Onderneming en Recht* part 44, p. 61, note 3.

[50] Mr A.C.F.G. Thiele in the collected *Zekerheidsrechten in ontwikkeling* [Security rights in development], Annual congress 2009 *Koninklijke Notariële Beroepsorganisatie* [Royal Professional Organisation of Civil-Law Notaries], p. 72, note 6.

[51] See Pen Kent in Corporate Workouts- a UK perspective, published in International Insolvency Review, 1997, vol 6, no 3, pp. 165-182

[52] As far as I am concerned, it goes without saying that the banking syndicate as such must be able to keep in control of the restructuring process; after all, they are the economic interested parties because they are “in the money”.

[53] Collective Action Clauses; the way forward, Robert Gray, pp. 11 et seq. at http://www.law.georgetown.edu/international/documents/Gray_000.pdf

homogeneity among the members of the banking syndicate with regard to facilitating restructuring by means of 100% consent. In other words, unanimity would occur automatically. Research conducted in the Netherlands into informal work outs shows that this assertion of Gray used to be true (in any case, in the past); banks in the Netherlands have played a positive role in informal reorganisations and usually cooperate on restructuring processes voluntarily.[54] Research of the IMF shows that this was partly caused by the desire of banks to maintain the relationship with their clients and the influence of supervisory authorities.[55] The second argument of Gray relates to the presence of so-called sharing clauses in the syndicated loans.[56] Summarily put, the result of such a clause is that an individual member of the syndicate has to share any sums received directly from the debtor with the other members of the syndicate.

24. However, as experience with the current crisis has taught us, the homogeneity in the syndicate – especially in the case of loans issued by a syndicate with a large number of members – is sometimes lacking. It think there is a number of reasons for this. Before the crisis, the syndicates were already open to financial institutions (including funds) other than banks. This already disrupted homogeneity. Moreover, in a time when banks themselves are disappearing and/or taken over, a banking syndicate as such is no longer very stabile. This lack of homogeneity is reinforced by the fact that the loans in the syndicate are going from hand to hand (including the hands of hedge funds and distressed debt traders).
25. So, the homogeneity argument – apparently – provides a vision on reality which is too narrow. After all, instead of awaiting payment from the debtor, the syndicate member can also choose to sell and transfer his share to a third party. The amount received as purchase sum does not fall under the sharing obligation. If you also consider the fact that the syndicate member may have stepped in (as a so-called distressed debt trader) at a value far below the nominal amount of the claim on the debtor, then it is clear that homogeneity need not be the case at all. Gray, for that matter, also acknowledges this and adds that the banks' different view of risk management has caused banks to try and hedge themselves against their credit risk by selling sub-participations or entering into credit default swaps, which disrupts the homogeneity of the syndicate even further. Based on this, Gray concludes that by now there is in fact reason to lay down collective action clauses. The required majority envisioned by him in this regard is higher than usual for bonds in the Netherlands; Gray propose a majority of 95%.[57]
26. In practice, I have not yet come across these collective action clauses in syndicated loans of companies.[58] Personally, I am greatly in favour of this. It simplifies the informal restructuring process in cases in which a (qualified) majority of the syndicate members are in favour of a restructuring, and only a (very small) minority oppose this. Gray states

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[54] See, among others, *Insolventie in economisch perspectief* [Insolvency in economic perspective], A.M. van Amsterdam (2004), Restructuring in the shadow of the law, J.A.A. Adriaanse (2005) and the WODC report from 2004 *Informele reorganisatie in perspectief van surseance van betaling, WSNP en faillissement* [Informal reorganization in the perspective of suspension of payments, Debt Rescheduling (Natural Persons) Act and bankruptcy]. These surveys also include restructuring processes involving several banks, see, for example, the WODC report, p. 58.

[55] Design and effectiveness of collective action clauses, IMF Legal, p. 20, at http://www.imf.org/external/np/psi/2002/eng/060602.pdf

[56] See about sharing in a general sense: Sue Wright in International Loan Documentation, pp. 217 et seq. (2006)

[57] Gray, loc. cit., p. 14, also see Design and effectiveness of collective action clauses, IMF Legal (2002), p. 20, at: http://www.imf.org/external/np/psi/2002/eng/060602.pdf

[58] This applies to syndicated loans issued under both English and Dutch law.

that the Loan Market Association[59] endorses this idea and takes a qualified majority of 95% as the point of departure. However, in the models of the Loan Market Association consulted by me I have not come across this (yet?).[60]

27. If Gray's proposal which I endorse, were to be adopted, it would be possible to convert part of the debt of a legal person into shares against the will of a minority of a syndicate. In doing so, - and in cases with various debt layers (Senior/Junior) - , it is also required to solve the matter of settling the mutual relationship between these layers of debt. In my opinion, the point of departure in this respect should be that for each class the (qualified) majority decides. In addition, one will have to consider if, and if so, under which circumstances, Senior lenders could force Junior lenders to cooperate if – for instance – the Junior lenders are fully out the money.[61]

IX. Syndicated loans, special tricks and conditions: exit consents, snooze you loose, delay and it is ok, yank the bank

28. Are there other ways of warding off individual dissenting syndicate members and force them to cooperate on a debt for equity swap if the syndicated loan does not contain any collective action clauses? The current practice of restructuring shows that there are many different ways of trying to sidetrack individual obstructing syndicate members.
29. Syndicated loan documents often include particular clauses seeking to mitigate the problem of individual obstructing members. These clauses have – colourful – names such as the "Snooze you loose clause", the "Delay and it is ok clause" and the "Yank the Bank clause" .[62]
30. Succinctly put, the Snooze you loose clause[63] implies that upon the lender's failure to respond on time, his vote is lost. There is a lot to be said in favour of including such a clause; it prevents lenders from failing to respond at all – something frequently seen in practice now – and frustrate the process.
31. The Delay and it is ok clause[64] means that upon the lender's failure to respond on time, the lender is deemed to vote in favour. Theoretically, this provides an escape route to the extent that inadvertent lenders are outvoted. However, both clauses eventually fail if the lender casts his vote in a timely manner, thus obstructing unanimity.

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[59] According to its website (http://www.loan-market-assoc.com/), the objective of the Loan Market Association is: "improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa. By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as the key debt product available to corporate borrowers across the region." Many larger scale financing operations in the Netherlands are documented according to English law on the basis of the LMA models. In other cases, the financing documents according to Dutch law are used, which in turn have been derived from the LMA models.

[60] Consulted models: the SENIOR MULTICURRENCY TERM AND REVOLVING FACILITIES AGREEMENT FOR LEVERAGED ACQUISITION FINANCE TRANSACTIONS, version July 2010 and MULTICURRENCY TERM AND REVOLVING FACILITIES AGREEMENT, version April 2009, website http://www.lma.eu.com .

[61] The comparison with the fully out the money shareholder imposes itself, also see Chapter XI.

[62] Examples, for that matter, are in many instances derived from syndicated loans governed by English law.

[63] Snooze you loose example: "If any Lender fails to respond to within X Business Days (unless the Borrower and the Agent agree to a longer time period in relation to any request) of that request being made, its Commitment and/or participation shall not be included for the purpose of calculating the Total Commitments or participations under the relevant Facility when ascertaining whether any relevant percentage of Total Commitments and/or participations has been obtained to approve that request."

[64] Delay and it's ok example: "If any Lender fails to respond to a request for consent, waiver, amendment of or in relation to any of the terms of any Finance Document within X business Days (unless the Borrower and the Agent agree to a longer time period in relation to any request) of that request being made, it shall be deemed to have granted such consent of waiver or consented to such amendment".

32. In that case, the Yank the Bank clause may be helpful.[65] This clause was drafted by lawyers of the sponsors (equity providers in leveraged finance deals) in the heyday of financing when banks queued up to provide finance and the lawyers of sponsors thought it was a good idea to have the possibility to replace a lender if this lender turned out unprepared to agree to a specific amendment to the documentation (after all, at the time there were two or three others willing and able to take this place). Considering the fact that lenders prefer to stick to a deal rather than step out, it was assumed that they would succumb to the pressure and agree just the same. In the practical cases known to me, this always, for that matter, concerns the lender's forced sale of his nominal outstanding debt obligation. In the United States, Cooper and Garcia have apparently also come across examples where the market value of the loan also suffices[66], but I have not found these yet (although they may be present in Europe also). A practical problem to be solved in this regard relates to the question of how the parties establish the relevant market value. I can imagine that in that case the documentation includes a particular type of third-party binding advice establishing the market value. A dissenting lender can then be removed from the syndicate against his will. Removal in this context, for that matter, means that there has to be alternative financing for this purchase.
33. Personally, I hold that removing a dissenting lender with a Yank the Bank clause at par or market value is an undeserved easy way out for this lender[67]. A well-know saying in the banking world – especially in times of crisis – is "cash is king". So why award an dissenting lender generously for his behaviour? In the United States, home of the syndicated loan, there is a fierce discussion regarding the question whether, and if yes, under which circumstances the individual "dissenting lender" can be forced to conform to the majority. This discussion is in part prompted by the so-called Beal Case[68]. This case related to a syndicated loan which included a so-called keep well agreement by way of security for the syndicate. [69] Against the will of the majority, an individual lender tried to take independent action under the keep well agreement. Eventually, the New York Court of Appeal confirmed the judgment of the lower court in the first instance to the effect that an individual lender of a syndicate was not allowed to address the provider of the keep well statement at law, independently and against the will of the other 36 members of the syndicate. In this case, the Court of Appeal concluded that the relevant agreement (the loan agreement and the keep well agreement) did not contain any specific clauses pursuant to which an individual lender was either or not allowed to take independent action against the issuer of the keep well agreement. In the absence of any clause to such effect, the Court of Appeal was forced to interpret the relevant agreements and

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[65]See in respect of the Yank the bank clause: Restructuring Law & Practice, Chris Howard and Bob Hedger (2008), pp. 23 et seq. and Richard J. Cooper and Dalman Garcia in Holdouts in syndicated loan rescheduling in Global Financial Crisis (2009) pp. 329 et seq., cf. the following exemplary Yank the Bank clause: "[then] the Borrower may, on X Business Days' prior written notice to the Agent and such Lender, replace such Lender by requiring such Lender to (and such Lender shall) transfer pursuant to Clause X (Transfers by Lenders) all (and not part only) of its rights and obligations under this Agreement to a Lender or other bank, financial institution, trust, fund or other entity (a "Replacement Lender") selected by the Borrower and which is acceptable to the Agent (acting reasonably), for a purchase price in cash payable at the time of transfer equal to the outstanding principal amount of such Lender's participation in the outstanding Utilisations and all accrued interest, fees and other amounts payable in relation thereto under the Finance Documents."

[66] Richard J. Cooper and Dalman Garcia in Holdouts in syndicated loan rescheduling, in Global Financial Crisis (2009) p. 330.

[67] In order to have the Yank the Bank clause work as adequate means of pressure, one may determine that the dissenting lender will not receive the market value for his {claim} but the market value minus a substantial reduction. I think that such a clause will not be accepted lightly by any member of a syndicate.

[68] Lenders 'Collective Action' Doctrine Provokes Controversy, New York Law Journal 14 December 2009, see also in the New York Law Journal of 16 May 2007 Lenders syndicates, Court rules Members cannot act individually, by Kenneth M. Black and Jeffrey B. Steiner.

[69] In the judgement the keep-well agreement is described as "a contract by a parent company promising financial assistance and management support for its subsidiary."

concluded that the individual lender was not allowed to take any such action. So, the individual lender cannot enforce his right at law individually.

X. Syndicated loans, are dissenting syndicate members always successful? Judicial sale as a means for restructuring

34. The finance documentation I know often specifically includes that the lender is allowed to take independent action.[70] Yet, the individual lender cannot enforce the security arrangements, this is the exclusive enforcement mandate of the so-called Security Trustee. The individual lender may, however, attempt to attach or – even – force bankruptcy of the debtor.[71] It should be noted that any proceeds obtained by the lender from such legal action must be shared with the other lenders on the basis of the sharing clause.
35. If the finance documentation gives rise to the conclusion that the individual lender has the option of taking legal action, it may still be possible that this individual lender cannot use this authority in case Dutch law applies to the contractual relation between the members of the syndicate. [72] Indeed, according to Dutch law, circumstances may give rise to the legal finding that an individual lender is deemed to abuse this right (Article 13, paragraph 2, Book 3 Dutch Civil Code) and/or that exercise of the individual creditor's (contractual) rights would be unacceptable according to standards of reasonableness and fairness (Article 2, paragraph 2, Book 6 Dutch Civil Code and Article 248, paragraph 2, Book 6 Dutch Civil Code) and/or that the individual lender acts unlawfully (Article 162, Book 6 Dutch Civil Code). I draw a comparison with the question if, and if yes, in which situations an individual creditor can be bound to a private agreement and I refer to (the literature written with reference to) the judgement of the Dutch Supreme Court in the Groenemeijer / Payroll case.[73] This judgement (and the literature discussing it) exemplifies that the Dutch Supreme Court is very tentative and that only in consideration of particular circumstances of the case to be adduced by the debtor, will the Dutch Supreme Court regard it possible to allow an action seeking cooperation to a private agreement. In the case at hand, it concerned a situation in which the natural person had already discontinued the business activities. This means that the question with relevance to the large number of financial restructurings, i.e., how do I retain as much value as possible for the joint stakeholders of the company (including the creditors), was not at issue here. In this sense, I concur with Wessels who remarks that: "I hold that in the case of a properly documented and independently evaluated offer which demonstrates that the debtor acts to the best of his abilities to pay his creditors while, for instance, submitting a

[70] Cf. this common clause: "A Finance Party may, except as otherwise stated in the Finance Documents, separately enforce its rights under the Finance Documents."

[71] In practice, for that matter, this does not happen; members of a syndicate do not take independent action but only try to oppose a restructuring as so-called non-consenting lender. The consequence of this behaviour is an actual and full standstill, the majority of lenders wish to restructure but cannot do so because a minority of lenders oppose this. The minority cannot proceed to judicial sale because the majority oppose this.

[72] Carefulness is in place here; as already mentioned earlier, many of the financing vehicles used in the Netherlands, including syndicated loans, have been prepared according to English law and designate the English court as forum agreed on. Consequently, English law applies to the contractual parties and the English court judges this matter on the basis of the applicable European Treaties, the Rome Convention and the EEX Convention. Here, I disregard the discussion about the question whether (a number of) the above-mentioned rules under Dutch law are binding to such extent that they always apply in the Netherlands, also if the agreement is governed by the law of another state. See in this respect: C. Drion in the status of reasonableness and fairness, *NJB* 2007/8.

[73] Dutch Supreme Court, 12 August 2005, *JOR* 2005, 257, *NJ* 2006, 230, see, for example, T.J.H. Akkermans in the informal reorganisation of insolvent companies, pp. et seq. – as always extensively documented - Bob Wessels in *Wessels-Insolventierecht* VI, par. 6208 et seq.

calculation showing that upon a quick bankruptcy the creditors will end up worse, a dissent will quickly be regarded as abuse".[74] I also hold that any preliminary relief proceedings in which the majority of syndicate members and the debtor (either or not supported by the Works Council) jointly act against the individual syndicate member and demonstrate in a properly documented manner that the individual syndicate member has no economic gain in attachment, or an application for bankruptcy, have (or at least should have) a fair chance of success when the relief sought relates to cooperation to a restructuring, or at least an injunction on levying attachment and filing an application for bankruptcy.[75] Indeed, the dissenting creditor does not have any individual interest to be observed. As far as I am concerned, especially the (blackmailing) tactics sometimes applied by the dissenting creditor seeking to get a better deal (from whatever party) than the other members of the syndicate, is something which should not be awarded at law.

36. If a claim for cooperation on a restructuring process fails but an – either or not provisional - injunction on levying attachment or forcing a bankruptcy is in fact awarded, then it may be possible in some cases[76] to effect an orchestrated judicial sale of a right of pledge on Dutch shares and in this way still realise a financial restructuring under application of Article 251, paragraph 1, Book 3 Dutch Civil Code. On the basis of this article, a pledgee may request the court sitting in preliminary relief proceedings to refrain from effecting the execution of a right of pledge on shares by public auction sale, and order a different manner instead, or request the court to determine that the shares will pass to the pledgee for an amount to be established by the court. Seeing that the democracy of syndicated loans is usually structured in such a way that a resolution of the lenders to instruct the Security Trustee to proceed to execution of the present security interests depends on a (qualified) majority (usually 66 2/3%), such an instruction can be given against the will of the dissenting lender, or it can be decided to pass the shares to the Security Trustee.
37. In 2009, a restructuring process – insofar as I know for the first time – was forced on the basis of paragraph 251, paragraph 1, Book 3 Dutch Civil Code. This related to the so-called SAS case in which an action seeking a different way of sale of pledged shares was brought before the Amsterdam court sitting in preliminary relief proceedings.[77] By now, this case has quite frequently been described in the literature, among others, extensively and clearly by Van Gasteren[78]. This case also received attention in the international literature, among others, from E.W. Purcell and Alex Boyce.[79] Within the framework of this article, I limit myself to a very summary representation. In the case of SAS, the value of the company broke in the junior financing. So, the value of the company was enough to redeem the entire senior debt, but only part of the junior debt. One of the Junior lenders disagreed with this valuation and refused to agree to the restructuring. As a result of the judicial sale of Dutch shares, the dissenting Junior lender was forced to settle for a small amount in cash (the amount his claim was worth according to the valuation of the

[74] Bob Wessels in *Wessels-Insolventierecht* VI, par. 6240, p. 131

[75] Cf. a special case in which a judgement creditor was ordered to lift the attachment in order to avoid execution of security interests by the bank, District Court of Roermond sitting in preliminary relief proceedings 6 November 2009, *LJN* BK2840. A similar action could be instituted against a dissenting senior, but also against a dissenting junior.

[76] There are, of course, many variants. In each instance, it is required to pose the question: where breaks the value and which financial creditors oppose this valuation; at the same time, the question will also always be: do the dissenting lenders have reasonable and feasible alternatives?

[77] Amsterdam District Court 10 September 2009 and 23 September 2009, *JOR* 2009, 340, with note by N.S.G.J. Vermunt

[78] Financial restructurings by means of execution sale of a right of pledge on shares, in *FIP* 2010, no 1 pp. 18 et seq. See also O.R. van Brunschot, Execution Sale of Pledged Shares in *FIP* 2009, no. 8, pp. 248 et seq. and the above-mentioned note of Vermunt. The author of this article was (loosely) involved in this deal as an interim lawyer for a financial institute.

[79] The Courts Speak on valuation in Restructurings: IMO Car Wash, SAS and Wind Hellas, International Corporate Rescue (2010), issue 2, pp. 129 et seq.

shares after restructuring). The finance documentation governed by English law included the (standard) clause that on the instruction of the majority of Senior lenders, the Security Trustee could enforce security arrangements and also that – insofar as the sale under execution comprised the judicial sale of pledged shares - the Security Trustee could discharge the company of which the shares were sold under execution (as well as the subsidiaries of this company) from any debts remaining after enforcement of the security interests.[80] The dissenting junior lender still had a residual claim on the company holding the shares sold under execution, but following private sale under execution this company no longer possessed any relevant asset.

38. So, for the senior lenders the proceeds from the sale under execution simply consisted of the same nominal debt obligation but now in respect of the buyer, whereas the proceeds of the dissenting Junior lenders consisted of "cash". This did not concern a debt for equity swap but a sale of the pledged shares whereby the sponsor also acting as shareholder (and therefore holder of the equity value), loaned part of the purchase price to the buyer of the shares. The Senior lenders carried their loans forward[81].

39. However, the Senior lenders may also choose to pass the pledged shares to the Security Trustee at an amount established by the court sitting in preliminary relief proceedings. In doing so, the debt for equity swap has been realised. Indeed, in that case, the Security Trustee has turned into shareholder of the company and will subsequently provide the shares to the lenders. The Security Trustee will have to make sure that this way of judicial sale of the right of pledge on shares is allowed on the basis of (the applicable law and) the substance of the syndicated loan (and intercreditor agreement, if any).[82] The debt of the Security Trustee to the shareholder consisting of the amount at which the shares have passed to the Security Trustee as determined by the court, may be set off against the claim of the Security Trustee on the holder of the shares, as long as this claim exceeds the value of the shares. [83]

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[80] For a more extensive account, see Van Gasteren, loc. cit., p. 19. The discussion about the exact content of the documentation, especially the intercreditor {agreement}, is still very much alive, see, for instance: Duffy, Choi, Glengarry and Gibson in International Corporate Rescue 2010, issue 4, p. 242 et seq. The Intercreditor Debate: Six Months On.

[81] Another interesting question is whether upon the sale of shares under execution, the dissenting junior or senior lender can be forced to accept that they will not receive cash, but merely a claim on the buyer. I think this is a better solution than application of the Yank the Bank clause, the dissenting lender is not rewarded for his behaviour in cash but gets exactly the same as the consenting lenders. In this respect, it remains to be seen whether such a non-cash element is in conformity with the Dutch legal provisions (among others, with respect to the division of proceeds after an execution sale of the right of pledge) which apply to the judicial sale of Dutch shares. With regard to an execution sale, one principally thinks of the payment of the object of the sale in the form of a cash purchase price. Particularly of interest are the provisions contained in paragraph 253, Book 3 Dutch Civil Code, and Articles 445 and 490-b of the Dutch Code of Civil Procedure. Succinctly put, these provisions (in the case of a situation with more than one titleholder to the proceeds from the judicial sale) imply that the enforcing pledgee ensures that the costs of the judicial sale are paid and that the pledgee may then deduct the proceeds from the amount payable to the pledgee. With regard to a remainder, if any, (i.e., a surplus value), it applies that – unless he reaches agreement with the other titleholders - the pledgee is held to deposit this amount at least up to the amount of the remainder with a depositary. Seeing that the Security Trustee as pledgee has the possibility to pay its own costs after settlement, I believe the Security Trustee can also decide – if this is allowed on the basis of (the applicable law and) the substance of the syndicated loan (and an intercreditor agreement, if any)– to refrain (for now) from collecting the amount due and agree that this amount falls payable at a later date, by way of deferred purchase price, or accept that this amount is paid in another way; in the SAS case, also, a substantial part of the proceeds consisted of the takeover by the buyer of the seller's debt to the syndicate (the Senior Loan). The court sitting in preliminary relief proceedings saw no reason in this for refusing its consent to the sale, and apparently accepted this consequence (but – admittedly – the court's judgement about this was not explicitly asked). See for the judicial sale by pledgee: N.S.G.J. Vermunt, *Enkele knelpunten bij pand, hypotheek en beslag* [Some bottlenecks in pledge, mortgage and seizure], in the collected *Onderneming en 10 jaar burgerlijk recht* [Company and 10 years of Dutch Civil Law] by Research Centre Company and law, part 24, pp. 341 et seq.

[82] Insofar as there is any doubt as to whether existing agreements contain this mandate for the Security Trustee, these agreements can be amended, that is, if such amendments are possible without the consent of the dissenting lender(s). See for the affirmative answer to the question whether such a structure also functions under English law: Chris Howard and Bob Hedger in Restructuring Law & Practice (2008), pp.187 and 188. See in respect of the authorities of the Security Trustee: Vermunt in his note under SAS, point 4.

[83] This will usually be the case in practice.

In that case, the claims of the lenders on the original debtor are not swapped for shares, but the lenders get an interest in a new entity whereby the economic result of the dissenting senior lenders remains the same. [84] As far as I know, a case of this nature has not yet been submitted to the Dutch court.

XI. The position of the shareholders in a debt for equity swap[85]

40. For the enforcement of a debt for equity swap, it is required that the relevant legal entity issues shares.[86] The authority to issue shares – save in the event of a delegation of powers - lies with the general meeting of shareholders[87]. In addition, the shareholders – with the exception of clauses of exclusion or limitation – have a pre-emptive right on new shares to be issued.[88]
41. Despite the fact that in situations of a debt for equity swap the shareholders are (seriously) out the money in an economic sense, this also means that the shareholders can in principle successfully oppose a debt for equity swap or demand that they wish to exercise their pre-emptive right. Shareholders may act this way in order to prevent that their interest is watered down. However, in many cases the present shareholders have no desire to exercise their pre-emptive right because they – contrary to the creditors looking to swap their debt for equity – have no claim on the company. If they wish to exercise their pre-emptive right, they will therefore have to pay up in cash, whereas the current creditors convert their present claims into shares.[89] It is also possible that the shares (including the related pre-emptive rights) of the legal person regarding which the debt for equity swap should be effected, are encumbered with a right of pledge including a (either or not conditional) voting right for the benefit of the Security Trustee of the syndicated loan. In that case the Security Trustee will be able to exercise its (voting) rights and will not require the separate cooperation of the shareholders[90].
42. The problems surrounding the financing of the company and its shareholders have been dealt with in the literature and in case-law. Cf. De Kluiver who refers to a judgement of

[84] See Chris Howard and Bob Hedger in Restructuring Law & Practice (2008), pp. 187 et seq. (in particular 6.126) for a description of a similar structure in the UK.

[85] Cf. in respect of debt for equity swap: Debt for equity swaps. N.W.A. Tollenaar in *De bewindvoerder, een octopus,* pp. 61 et seq., Loan Workouts and debt for equity swaps, Subhrendu Chatterji and Paul Hedges (2001), Restructuring Law & Practice, Chris Howard and Bob Hedger (2008), in particular, pp. 176 et seq. and Karl Clowry, Debt for Equity Swaps in Restructuring and Workouts. Strategies for Maximising Value (2008), pp. 27 et seq.

[86] The term relevant entity has been consciously chosen; in a restructuring of an existing company this will be the existing shareholders, whereas in the case of a restructuring by means of an execution sale this will be the shareholders of the buyer. In the latter case, no new shares will be issued but the shares in the (holding) company of the enterprise will be transferred to the buyer. Below, I only discuss the influence of the existing shareholders in the case of a restructuring within an existing entity.

[87] Cf.. Article 96, paragraph 1, Book 2 Dutch Civil Code in respect of a company limited by shares and Article 206, paragraph 1, Book 2 in respect of a private company. In practice, delegated authority, if issued at all, is rarely sufficient because delegation is usually issued for a limited number of shares only.

[88] Cf.. Article 96a, Book 2 Dutch Civil Code in respect of a company limited by shares and Article 206a, Book 2 Dutch Civil Code in respect of a private company.

[89] Cf. Tollenaar, loc. cit., p. 79 about the exact technique of this conversion. In practice, the payment is effected by setting off the payment obligation on the shares to be issued to the creditor against the claim of that creditor on the company, such on the basis of a set-off agreement further to the provisions of Article 80, paragraph 4, Book 2 Dutch Civil Code and Article 101, paragraph 3, Book 2 Dutch Civil Code, cf. also *Van de BV en de N.V* [On the private company and company limited by shares]., Winter (as successor of Van Schilfgaarde) 15^{e} edition, p. 81 – the company's debt to the creditor set off against the company's claim on the creditor in respect of his obligation to full payment on the shares.

[90] Cf. about the right of pledge on shares, R.W. Clumpkens in *Zekerheden in ontwikkeling* [Securities in development], Annual Congress 2009 *Koninklijke Notariële Beroepsorganisatie*, pp. 19 et seq.

the Dutch Supreme Court in the Skygate case[91], in his article "*Noodzaakfinanciering en de rol van de rechter*" [Corporate emergency funding and the role of the court]. In this case, the Enterprise Chamber concluded that in view of the circumstances of this special case, the management board of the company was authorised to adopt a resolution for the issue of a loan to be converted into shares. A loan converted into shares is a share subscription right which also commonly belongs to the authority of the shareholders.[92] The Dutch Supreme Court sanctioned this judgement. Partly on the basis of two subsequent judgements of the Enterprise Chamber, De Kluiver formulates the rule of law that "(i) when the company's interest requires additional financing because in the absence thereof, the company is in danger of suspension of payments or bankruptcy, and (ii) when a shareholder is prepared to provide this financing, it may be in conflict with standards of reasonableness and fairness if co-shareholders oppose provision of this loan through share issue."[93]

43. The rule of law formulated by De Kluiver assumes the provision of additional financing as part of the refinancing in order to provide the company with sufficient liquidity. In the case of a pure debt for equity swap this is not necessarily the case; the present financing is sometimes also converted into equity in order to improve the company's financial strength without providing new funds. On the longer term, companies cannot do without healthy balance sheet ratios if they wish to survive. The question is whether it is also possible to force a dissenting shareholder to cooperate in cases where no new funds are provided. In 2009, De Kluiver, in his capacity of advocaat [solicitor], managed to draw an affirmative answer to this question from the Enterprise Chamber in the case which cumulated in the Inter Access judgement.[94] In this case, a minority shareholder was prepared to convert his claim into shares, provided that the pre-emptive right of the current shareholders would not be applied so that the minority shareholder became a majority shareholder. The majority shareholder refused to agree to the resolution for share issue and also refused to agree to rejection of the pre-emptive right. In doing so, the majority shareholder also invoked a shareholders' agreement which provided that, succinctly put, his interest would not be watered down. After reaching the conclusion that the company has an urgent interest in conversion, the Enterprise Chamber adjudicated that the issue could be effected without the consent of the majority shareholder, notwithstanding this shareholder's pre-emptive right and the provisions of the shareholders' agreement.[95]
44. I applaud the judgement of the Enterprise Chamber.[96] It provides law professionals with the tools to point out to malicious, dissenting and uncooperative shareholders that it is

[91] H.J. de Kluiver, *Noodzaakfinanciering en de rol van de rechter* in the collection *De Financiering van de onderneming* [Financing the company], part 88 of the series commissioned by the van der Heijden Institute, p. 21, Dutch Supreme Court 19 October 2001, *JOR* 2002, 5 Skygate, see also Chr. M. Stokkermans in *Preadvies, Het nieuwe BV-recht voor de praktijk* [Pre-advice, The new private company law for the professional practice], p. 113 describing this case as an example where an appeal to the shareholders' agreement conflicts with Article 8, paragraph 2, Book 2 Dutch Civil Code.
[92] Cf. Article 96, paragraph 5, Book 2 Dutch Civil Code in respect of companies limited by shares and Article 206, paragraph2, Book 2 in respect of private companies.
[93] De Kluiver, loc. cit., pp. 34 - 37.
[94] Enterprise Chamber 31 December 2009, BL 3690, JOR 2010, 60 (note by Doorman), cf. J.W. Leedekerken in TOP 2010, no 4., p. 143 and Assink in Company law 2010, no. 7. The Financial Newspaper of 11 February 2010 and the note of Assink, for that matter, demonstrate that the majority shareholder appealed from this judgement, so the case is not definitely decided yet.
[95] I, for that matter, concur with the advice of *Mr* Leedekerken on page 143 that it is better to leave the pre-emptive right of the shareholders intact and provide them with the opportunity to participate. As already stated above, the fact that the existing shareholders usually do not have a claim on the company and are therefore forced to pay up in cash for the shares, has as a consequence that they are only rarely interested in exercising their pre-emptive right. And in the event they do exercise this right, the company is provided with new and fresh funds.
[96] It is always difficult to make a balanced judgement about a case based on the public documents; as to whether Willemse really is a malicious dissenting shareholder in this matter I cannot say without taking cognisance of his exact motives.

possible to bring the matter before the court which may result in a court order issued against the dissenting shareholder.[97] The comment of Assink to the effect that it, summarily put, involves a matter of expropriation, does not – at least, not from the perspective of the economic reality of a debt for equity swap – appeal to me. Indeed, in this case a creditor who is on the side of the shareholders, is prepared to convert his claim and become a shareholder himself with the objective of serving the interest of company's continuity. The fact that the creditor also has an interest in acting this way does not detract from this. The existing shareholders did not (or no longer) have any economic entitlement because they were out the money anyway. I fail to see that this concerns a matter of (economic) expropriation of existing shareholders, but rather regard it as a corrective measure in respect of the fact that the shareholders have been overtaken by economic reality and now no longer should have any say. As far as I am concerned, this would only be different if the existing shareholders are prepared to co-finance the restructuring (for instance, by subscribing to new shares themselves) and/or present an alternative plan on time.[98] In respect of this, I realise that here also the above-mentioned valuation issue (when are the existing shareholders really completely out the moment?) is decisive.

XII. Conclusion

This articles discusses whether it is possible, and if yes, under which circumstances, to force dissenting bondholders, syndicate members and shareholders to cooperate on a debt for equity swap. The article starts with a discussion of the current financial crisis in order to exemplify why this crisis causes financial difficulties for companies. If the burden of debt obligations becomes so big that the company is not able to meet any of its obligations, neither on the short term nor on the long term, it is desired to proceed to a restructuring of the company. In this respect, it is often much more efficient and effective to proceed to an informal restructuring instead of formal insolvency proceedings. In doing so, the technique of converting part of the debt into shares (debt for equity swap) is often used. Within this framework and especially for practical reasons, only the shareholders and the so-called financial creditors (bondholders and syndicate members) are asked to cooperate. However, such an informal restructuring in principle requires the consent of all financial creditors involved because part of their debt will be converted into shares and the applicable finance documents disallow forcing them to cooperate against their will. Only if the documents contain so-called collective action clauses does a resolution of a (qualified) majority of the financial creditors suffice for the conversion. Bonds issued under Dutch law contain collective action clauses, whereas this is (in the opinion of the author, mistakenly) uncommon with syndicated loans. If the syndicated loan is governed by Dutch law, it may be so that on the basis of Article 13, paragraph 2, Book 3 Dutch Civil Code and/or Article 2, paragraph 2, Book 6 Dutch Civil Code and/or Article 248, paragraph 2, Book 6 Dutch Civil Code and/or Article

[97] I refrain from going into the complications of the proceedings and the matter of which court is the best choice, see in this regard, among others, De Kluiver and Leedekerken. I, for that matter, believe that in some cases it should be possible to ignore the entire shareholders' meeting if they are fully out the money. Similarly, it is my opinion that the Senior lenders should also be able to sidetrack the junior lenders who are fully out the money.

[98] Cf. for a case in which the parties entitled to the equity were too late, at least in the opinion of the Enterprise Chamber, with presenting their alternative plan, the Almatis case, Enterprise Chamber 12 April 2010, LJN BM1437; it appears that the parties entitled to the equity eventually succeeded to force an alternative plan in the Chapter 11 proceedings to which Almatis is subjected, cf. the Almatis press release dated 4 August 2010, at http://www.almatis.com/download/press-releases/PR04_20100803_Alternative_Plan_Filing.pdf. By now, the bankruptcy judge has approved the disclosure statement, see http://www.cmemarkets.com/v3/2010/08/23/dj-creditors-cleared-to-vote-on-almatis-bankruptcyexit-plan/

162, Book 6 Dutch Civil Code, the Dutch court forces the dissenting lender to cooperate if so requested by the majority of the syndicate and the company (and any other interested parties). If it concerns a financial restructuring of a business carried on by (intermediate) holding companies in the Netherlands, the majority of syndicate members may be able under specific circumstances and dependent on the (substance of the) documentation to force cooperation of the minority of the individual syndicate members by means of an execution sale in the Netherlands of the shares in the Dutch company. This article discusses how such an execution sale may in some cases also force the individual non-consenting lender to cooperate on a structure which in an economic sense has the same result as a debt for equity swap. In addition, according to legal precedent, an obstructing, non-consenting shareholder can also be forced to cooperate on a debt for equity swap.