

FINANCIAL COLLATERAL AGREEMENTS AND THE DUTCH SCHEME ("WHOA"): CHANGES WITH EFFECT FROM 1 JANUARY 2023

Early 2022, after a public consultation, a Bill was introduced to Parliament to make certain changes to Dutch bankruptcy law to implement the EU Restructuring Directive 2019/1023. This Bill, which became law on 1st January 2023 (the "**Restructuring Law**"), also amends certain aspects of the WHOA and these changes are likely to benefit creditors whose claims are secured by way of a financial collateral arrangement ("**FCA**") significantly. Its implications for financial transactions and derivatives with Dutch entities that are covered by the WHOA are the main topic of this briefing. Moreover, for unsecured creditors the explanatory remarks to the new law contain a novel and beneficial interpretation of protections available to them in case they are faced with a default by their debtor prior to a stay period imposed under a Dutch Scheme. This aspect will also be addressed in this briefing.

1. INTRODUCTION OF THE DUTCH SCHEME

Since 2021 Dutch law provides for pre-insolvency debt restructuring schemes. This new tool is available to all Dutch business entities (including, theoretically, Dutch pension funds¹) except Dutch credit institutions and insurance companies. This law is known as the Act on Court Approved Pre-Insolvency Restructuring Schemes ("**WHOA**" following the Dutch abbreviation).

The WHOA's goal is to introduce a restructuring procedure enabling debtors in financial difficulties to restructure at an early stage and avoid insolvency while remaining in control of their business. To use this new procedure, debtors

Key issues

- Previously the WHOA only partially exempted creditors with a financial collateral arrangement (qualifying under the Collateral Directive) from the WHOA's scope.
- This has been expanded into a total exemption with effect from 1 January.
- Other creditors faced with a default by their debtor occurring prior to the WHOA's stay period were exposed to uncertainty over when they might be entitled to terminate and close-out their contract after the WHOA Stay commenced.
- This has been addressed by a novel interpretation by the Government set out in the parliamentary papers for the new law. This clarifies that the debtor must provide collateral before the stay order takes effect in order to avoid that its creditor is able to terminate the contract due to a Regular EoD (pre-stay).
- The EU Restructuring Directive 2019/1023 has now been implemented in the Netherlands.

¹ Theoretically, because pension funds are able under law to reduce their liabilities unilaterally.

must foresee that they will not be able to continue paying their due and payable debts.²

Under such circumstances, the debtor or a court appointed restructuring specialist may offer a restructuring plan to the debtor's creditors and shareholders. Before offering a WHOA restructuring plan ("**WHOA Restructuring Plan**"), the debtor must file a confidential scheme declaration with the competent Dutch court in which it commits to offer a WHOA Restructuring Plan within 2 months (the "**Scheme Declaration**") and it may then simultaneously request the court to order a general or specific stay (the "**WHOA Stay**") against bankruptcy petitions and enforcement actions by creditors for a period of 4 months (with a possible extension of up to 4 months). A WHOA Restructuring Plan could propose amendments to debt instruments, payment deferrals, debt-for-equity swaps, haircuts / write-downs of all or certain creditors and termination of executory contracts (where the counterparty did not voluntarily cooperate with a proposal to amend or terminate the contract). Not all the debtor's creditors need to be covered by the WHOA Restructuring Plan. Creditors are grouped in separate classes (depending on their ranking in an insolvency) that vote separately on the proposed plan. Subject to certain safeguards, creditors who voted against the WHOA Restructuring Plan could be (cross-) crammed down and bound by the WHOA Restructuring Plan if a majority (of 2/3 of the value) of creditors within a class (or a more senior class) vote in favour of such a plan and the court subsequently approves the plan.

2. DUTCH BILL IMPLEMENTING THE EU RESTRUCTURING DIRECTIVE

Early 2022, after a public consultation, a Bill was introduced to Parliament to make certain changes to Dutch bankruptcy law to implement the EU Restructuring Directive 2019/1023. This Bill, which became law on 1st January 2023 (the "**Restructuring Law**"), also amends certain aspects of the WHOA and these changes are likely to benefit creditors whose claims are secured by way of a financial collateral arrangement ("FCA") significantly. Its implications for financial transactions and derivatives with Dutch entities that are covered by the WHOA are the topic of this briefing.

The Restructuring Law exempts creditors with an FCA (and those with a netting agreement forming part of an FCA) entirely from the effects of WHOA Proceedings. Under the 'old' WHOA these creditors only had an exemption from the WHOA Stay period in terms of being permitted to enforce their security rights during such a WHOA Stay (see 4(b) below). Since the Restructuring Law took effect, such creditors can entirely ignore WHOA Proceedings and exercise their rights unobstructed. This was necessary in order to align the position of such creditors with their position in bankruptcy proceedings and to comply with art. 31 of the EU Restructuring Directive which states that its provisions shall not prevail over the Collateral Directive. The effect of this new exemption for FCA's is dealt with in more detail in paragraph 3.

² This means that the debtor must be able to pay its currently due and payable debts, but not those arising in the foreseeable future (looking as much as a year in the future). I.e. there must be no realistic prospect of avoiding a future insolvency if the debtor's liabilities are not restructured.

In addition, following a position paper submitted to Parliament in May 2022 by Energie-Nederland and the European Federation of Energy Traders (EFET)³ pointing out certain negative aspects of the WHOA's Stay period for wholesale parties in the gas and electricity markets dealing with Dutch counterparties, and requesting that the future Restructuring Law implement article 7(6) of the Restructuring Directive by exempting energy and commodities derivatives contracts from the WHOA's Stay period entirely (as was done in the UK and Germany), the Government responded at the end of June in the "*Nota naar aanleiding van het Verslag*" (the "**Nota**") by providing a novel interpretation of the WHOA Stay period. This interpretation (which will be discussed under 5 below) was novel in that there was precedent for it neither in the WHOA's own legislative history nor in legal literature. It eliminates one of the principal risks from the WHOA Stay period for unsecured creditors in and outside the energy sector.

3. EXEMPTION FOR FCA'S

By entirely exempting creditors with an FCA from the WHOA, such creditors and their claims cannot be included in a WHOA Restructuring Plan and their contracts will not be affected by the mandatory default override (prohibiting the use of trigger events that qualify as WHOA Events - see 4(a) below) nor by the court ordered WHOA Stay period (see 4(b) below) nor by a court approved contract termination by the WHOA debtor (see 4(c) below).

Although not relevant to the subject of this briefing:

- a complete exemption is also now available for pension funds' premium claims, employee pension benefit claims, security interests granted by or to participants in payment and settlement systems (as defined in the Finality Directive);
- in line with article 31 of the Restructuring Directive, the WHOA was amended to clarify that it cannot adversely affect the rights of counterparties and CCPs under EMIR (e.g. counterparties to uncleared otc-derivatives holding margin as required by EMIR) or the safeguarding of client monies under the Payment Services Directive or the Electronic Money Institutions Directive.

Creditors without an FCA will continue to be exposed to certain areas of risk, which are described in 4 below. Their position has, nevertheless, been improved by the interpretation in the legislative history of the Restructuring Law which is discussed in 5 below.

4. IPSO FACTO, SUSPENSION AND TERMINATION RIGHTS UNDER THE WHOA (NON-FCA CREDITORS)

(a) Mandatory Default Override

Under the WHOA, the preparation or proposal of a WHOA Restructuring Plan, the appointment by the court of a restructuring expert or the occurrence of any other event or act directly related or reasonably required for the plan's implementation (including a WHOA Stay; see paragraph (b) below; together "**WHOA Events**"), shall not in themselves allow the creditor to invoke contractual or other powers:

³ <https://www.energie-nederland.nl/zienswijze-energie-nederland-op-wetswijziging-wet-homologatie-onderhands-akkoord/>, Available only in Dutch.

- (i) to terminate or dissolve a contract (whether automatic or by notice),
- (ii) to amend obligations owing to the counterparty or
- (iii) to suspend the performance of its own obligations towards the counterparty.

Events of default clauses that could be triggered by such WHOA Events cannot be validly invoked against the debtor; the WHOA simply overrides such contractual provisions.

(b) Court ordered WHOA Stay Period

During a court-ordered WHOA Stay lasting 4 months (with possible extensions with no more than a further 4 months), the debtor will be protected against:

- the filing of bankruptcy petitions;
- the enforcement of security interests over assets owned by it unless a safe harbor applies (see paragraph (c) below);
- the levying of attachments for contract/payment enforcement, unless the court specifically approves such actions by the debtor; and
- the use of an event of default (not being a WHOA Event; hereinafter a "**Regular EoD**") that occurred before the WHOA Stay order and that allows the creditor to suspend, amend or terminate an agreement or contract. Such use will be blocked as soon as the WHOA Stay order takes effect (i.e. in all cases where the stay order is issued before the suspension, amendment or termination is declared) and until the end of the stay period. For exceptions to this blocking effect and for using a Regular EoD occurring during the stay period, see (i) below.

The exercise of termination or close-out rights is not affected by a WHOA Stay period, *except as a result of the final paragraph*.

(i) Negative Effect of Unexercised pre-stay Regular EoD: In the case of a Regular EoD occurring prior to the WHOA Stay order without the creditor exercising its termination rights before the order takes effect, that Regular EoD cannot be used during the WHOA Stay period and the creditor can be required to continue the performance of its obligations under the defaulted Transaction BUT ONLY IF the debtor provides the creditor with sufficient collateral security for its obligations arising during the WHOA Stay period. In the event the debtor fails to offer or provide such collateral security, this shall allow the creditor to exercise its termination, suspension, close-out netting rights resulting from the pre-stay Regular EoD. If any collateral security made available to the creditor becomes (or threatens to become) insufficient during the WHOA Stay period, it can petition the court to allow it to exercise its termination/close-out rights arising from the pre-stay Regular EoD and enforce its security interests forthwith and the court will have no option but to grant a permission in such circumstances.

In short, a non-FCA creditor confronted with the situation outlined above, can ONLY exercise its termination and close-out rights during the WHOA Stay period:

- (a) if the debtor fails to provide it with collateral security for all liabilities that arise during the stay period; or
- (b) if the debtor does provide collateral security immediately, but it becomes insufficient; in that case the creditor needs prior court

approval to exercise its termination or close-out right, thereby incurring a significant timing risk by having to petition and argue before the courts;

but if the termination amount is owing to the creditor after (a) or (b):

- recourse against the debtor's assets is not permitted for the duration of the stay period and this creditor will need to wait until the end of that period before it can enforce that debt;
- if that claim is included in the WHOA Restructuring Plan, this creditor will need to wait until the end of the WHOA Proceedings and it faces the risk (if this claim is included in the WHOA Restructuring Plan) that the claim is marked down (i.e. made subject to a haircut) or partially converted into equity (as a result of a debt-for-equity swap proposed in the WHOA Restructuring Plan), but in such a situation the creditor can raise the "no-creditor-worse-off" challenge (see (c) below); but
- the creditor can claim under a letter of credit (or any other form of guarantee) for the termination amount owing to it regardless of the WHOA Stay period.

The same recourse limitations apply to a non-FCA creditor who is not facing a Regular EoD prior to the WHOA Stay order, and who must continue performing its obligations under the contract until a Regular EoD occurs. Once this Regular EoD occurs during the WHOA Stay period, this creditor can exercise its termination, suspension and close-out rights pursuant to the relevant contract (such rights are not frozen or barred by a WHOA Stay; see (b) above).

(ii) Enforcement of Security Interests: As regards enforcement of security interests (not qualifying as an FCA), a WHOA Stay order does not affect:

- secured creditors who are unaware of the fact that a WHOA Restructuring Plan was being prepared (i.e. had no knowledge of the filing of a Scheme Declaration and had not otherwise been informed by the debtor) or that a WHOA Stay order had been granted;
- the enforcement of security interests in respect of collateral located in other EU Member States or in non-EU countries.⁴

(c) Contract Termination by the Court

If during WHOA Proceedings a non-FCA creditor does not agree to a proposal by its debtor to amend or terminate a mutual agreement, and it cannot close-out this agreement itself based on a Regular EoD (see (b) above), the court can allow the debtor to unilaterally to terminate the agreement (and all transactions thereunder) if such termination is part of the WHOA Restructuring Plan submitted to and approved by it and provided a reasonable notice period is observed by the debtor. In the event of such a termination, the creditor will be legally entitled to damages, which will be calculated on the basis of the agreed close-out netting arrangements (including the application of any

⁴ In respect of EU Member States, this safe harbour is only useful if no event of default is required under the relevant agreement in order to enforce the security interest, because a termination triggered by a pre-stay Regular EoD would be blocked for the duration of the stay period (which blocking must be recognized in other EU Member States except Denmark and Ireland) and thereby frustrate the enforcement of the security interest.

collateral held by either Party); the damages will therefore consist of the amount of the creditor's net claim against the debtor after giving effect to the netting provisions upon the date the termination becomes effective; this claim can be marked down or partially converted into equity if it is integrated into the WHOA Restructuring Plan⁵ (note that the mark-down or other loss cannot be greater than that suffered by the creditor in the debtor's bankruptcy; the "no-creditor-worse-off" principle).

5. 'OFFICIAL' GUIDANCE ASSISTING NON-FCA CREDITORS REGARDING PRE-STAY REGULAR EOD'S

In their position paper presented to Parliament during the debate on the draft Restructuring Law⁶, **Energie-Nederland** and **EFET** had criticized the lack of protection from the WHOA Stay period for unsecured creditors who had not exercised their termination rights based on a Regular EoD that occurred before the WHOA Stay order (as discussed in 4(b) above). The position paper highlighted that most parties in the wholesale energy markets do not use collateral arrangements to secure their mutual exposures or, alternatively, do not qualify as 'eligible parties' for an FCA. They must therefore be treated under the WHOA, in principle, as 'regular' unsecured creditors.

The principal concern expressed in the position paper was that debtors could create a period of uncertainty for such unsecured creditors because the WHOA does not specify what collateral should be offered, how much or by when. The typical contracts in the energy markets would also not provide terms in this respect. Consequently, creditor and debtor could be caught up in lengthy negotiations over collateral before it becomes clear that the debtor is unable (or unwilling) to provide collateral in form and quantity acceptable to the creditor. Only at that point in time would the creditor be entitled to stop its own performance under the contract and terminate the outstanding Transactions based on the pre-stay Regular EoD. During this delay, the value of the terminated Transactions may well have moved against the creditor.

This uncertainty has been removed by a novel interpretation by the Government contained in the Nota. **This states that the collateral should be provided by the debtor BEFORE the stay order, meaning that the debtor can only avoid the creditor's exercise of its termination, close-out or suspension rights pursuant to the pre-stay Regular EoD if it proactively ensures that the creditor has received acceptable and sufficient collateral BEFORE it applies for a stay order.** For those contracts that the debtor does not wish to continue, it will simply not offer the creditor any collateral before the stay order and the creditor will then be at liberty to terminate the relationship immediately or continue performing the contract (taking the risk that the debtor might default again, but during the stay period). In practice, this will mean that a debtor who prefers to continue a specific contract during a stay period on which it has defaulted before that stay period, will need to have a collateral offer in its back pocket before requesting a stay period, to avoid that the creditor can make use of its termination rights in the (energy-)contract.

⁵ The debtor has a choice to either include the termination amount in the WHOA Restructuring Plan or not to do so. In the latter case, the damages will need to be paid in full. In the former case it can offer a partial payment, but the counterparty then has the right to contest the WHOA Restructuring Plan as an affected creditor.

⁶ Available only in Dutch: <https://www.energie-nederland.nl/zienswijze-energie-nederland-op-wetswijziging-wet-homologatie-onderhands-akkoord/>

6. CONCLUSION

The improvements to the WHOA that came into force with the Restructuring Law should enhance the position of creditors with an FCA, as well as the rights of non-FCA and unsecured creditors who are faced with a Regular EoD occurring prior to a WHOA Stay.

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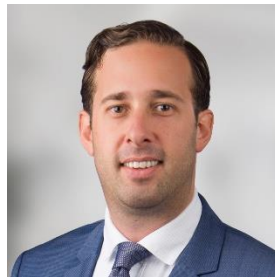
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