WEGPOETS WHOA OR SCHEME OF ERASURES?

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Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht **(NVRII)** / Netherlands Association for Comparative and International Insolvency Law **(NACIIL)**

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Reorganization procedures are sometimes a better way to deal with (pre-)insolvent companies than to liquidate them. Not only is the outcome of a reorganization procedure markedly different from a liquidation procedure, also the way of dealing with the past is quite different. In liquidation procedures, an appointed insolvency practitioner will review transactions conducted prior to insolvency through the lens of transaction avoidance and review behaviour of directors and shareholders through the lens of liability. Reorganization procedures are so strongly geared towards saving the business and the company and thereby so forward-looking, that there appears to be little room for looking back. One could even question whether a less noble goal of starting reorganization procedures might in some cases be to prevent looking back.

During the 2025 Netherlands Association for Comparative and International Insolvency Law (NACIIL) annual meeting 'Wegpoets-WHOA or Scheme of Erasures? Difficulties of applying transaction avoidance in reorganization procedures', we explored the dilemmas of to looking back in a reorganization procedure from a US, English and Dutch perspective, with a focus on transaction avoidance. This book contains the reports that were prepared for the 2025 NACIIL annual meeting.

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Wegpoets WHOA or Scheme of Erasures?

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Brook E. Gotberg, Sarah Paterson and Krijn Hoogeboezem

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Preface

Reorganization procedures are sometimes a better way to deal with insolvent companies than to liquidate the company. Reorganization procedures aim to capture the going concern value for creditors by 'right-sizing the capital structure' or providing creditors with a necessary and often overdue 'hair-cut'. These metaphors do not take away that creditors are commonly forced to accept less than full payment on their claims.

Not only the outcome of a reorganization procedure is markedly different from a liquidation procedure, but also the way of dealing with the past is quite different. In case of liquidation procedures, an appointed Insolvency Practitioner will review transactions conducted prior to insolvency through the lens of transaction avoidance and review behaviour of directors and shareholders through the lens of liability. Reorganization procedures are so much geared towards saving the business and the company and are thereby so much forward-looking that there appears to be little room for looking back. One could even question whether a less noble goal of starting reorganization procedures might in some cases be to prevent looking back.

On 3 June 2025, the NACIIL organised its 2025 annual meeting: 'Wegpoets-WHOA or Scheme of Erasures? Difficulties of applying transaction avoidance in reorganization procedures'.[1] NACIIL is honoured that distinguished academics and practitioners from different jurisdictions devoted their time to writing and presenting a report.

A report with the US perspective was prepared by Prof. Brook Gotberg (BYU University, US), entitled *Looking Backward, Looking Forward and Preference Liability in Reorganization Bankruptcies*. Her report defends the continued relevance of preference avoidance in reorganization proceedings while challenging the traditional rationales commonly invoked to justify it.

A second report was written by Prof. Sarah Paterson (LSE and senior consultant to Slaughter and May, UK) entitled, *English Restructuring Law: Full Steam Ahead or a glance in the Rear-view Mirror?* Prof. Paterson investigates the extent to which restructuring results in the loss of valid claims against the company or the directors to avoid transactions entered into in the run-up to financial distress. We regret that after writing her report, Prof. Paterson could not join us in person during the actual annual meeting. We would like to thank Géza Orbán, who stepped in and presented the report

1 Our NACIIL board member Lilian Welling-Steffens won the contest of translating 'Wegpoets-WHOA' into English by coming up with the term *Scheme of Erasures*.

written by Prof. Paterson. This provided for a lively format with Géza Orbán presenting the Report and Prof. Paterson answering questions via zoom.

In the Netherlands, the enthusiasm for the new reorganization procedure in the WHOA has been so strong that very little attention was being paid how to apply traditional methods of creditor protection. Most energy was being put into creating solutions and little into asking the question as to the cause of financial problems and possible responsibility related thereto. Krijn Hoogeboezem (Resor advocaten) took it upon him to fill this gap. He went above and beyond and delivered an in-depth analysis of practically all questions that can come up under a reorganization procedure in his report entitled *From avoidance to value. Pre-filing irregularities under the WHOA*.

We would like to thank the authors for their Reports and our members and attendees for engaging in a debate with the authors. We would also like to thank Houthoff for hosting the event on the 23rd floor overlooking Amsterdam.

Board of the NACIIL, Amsterdam 2025

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Looking Backward, Looking Forward and Preference Liability in Reorganization Bankruptcies

Brook E. Gotberg[*]

Introduction

The law on preferential transfers is one that scholars love to hate and with good reason. At its worst, preference avoidance functions as a highly inefficient mechanism to capriciously redistribute wealth, often away from unsuspecting and unsophisticated players.[1] At its best, the avoidance of preferential transfers funnels resources into litigating whether prior legitimate debt payments should be unwound at a time when the ongoing viability of the debtor is at stake, a potentially fruitless and costly endeavour. The law thus invites the debtor, its creditors and the court to turn their attention and energies to transactions that occurred in the past, rather than looking forward to the future. Bankruptcy is intended to encourage the future productive use of capital and assets, making this backward-looking approach apparently counterproductive.

A preferential transfer is an avoidable action in bankruptcy. This means that the transfer, which takes place before the bankruptcy filing, can be clawed back during bankruptcy proceedings. A preferential transfer is therefore like a fraudulent transfer, but it is also fundamentally different because preference avoidance requires no proof of intent nor any demonstration that the transfer was not given for a reasonably equivalent value. Under preference law as presently interpreted, an otherwise fully legitimate transfer made by parties innocent of any wrongful intent can be and often is unwound. Avoidance actions may be brought in every type of bankruptcy – consumer and commercial, liquidation and reorganization. This makes preference avoidance

* Professor of Law, Brigham Young University Law School. Professor Richard Squire, Professor and Alpin J. Cameron Chair in Law, Fordham University School of Law, provided valuable insights and helpful edits to this report.

1 *See* David A. Lander, *Is Preference Litigation Worth Its Cost? Toward a Data-Based Answer*, 11 Norton Bankr. L. Advisor (2019). Not surprisingly, Lander's conclusion is that preference litigation is not worth the cost, insofar as it does not result in the more equitable sharing of the debtor's assets, recovers only a fraction (about 15%) of the total avoidable sum, and does not meaningfully increase the amount available for distribution. *Id.*

one of the most prominent and controversial causes of action raised in bankruptcy proceedings.

The purposes of preference law have been an enigma[2] to scholars for many years. But as Professor Richard Squire and I argue elsewhere,[3] the logic underlying the avoidance of preferential transfers is rooted in one of the primary purposes of business bankruptcy law. That same logic also informs other key provisions of the U.S. Bankruptcy Code, like the automatic stay. The purpose of both preferential transfers and the automatic stay is to discourage or disable creditors from engaging in zero-sum competition for a debtor's assets when the debtor is insolvent. The expenses that creditors incur when engaged in such competition serve no purpose but to change the distribution of losses among them. The expenditure thus reduces creditors' overall net recoveries, leaving creditors collectively poorer. By discouraging such wasteful competition, bankruptcy law increases creditors' net recoveries *ex post*, which in turn reduces debtor borrowing costs *ex ante*.

The automatic stay renders all actions to collect against the debtor void or voidable, disabling creditors from engaging in collection efforts that would merely redistribute losses. It thus serves to minimize creditors' recovery costs by discouraging the expenditure of resources on zero-sum efforts to collect. Creditors cannot benefit themselves from post-filing collection efforts because any action taken to improve a creditor's position after a bankruptcy filing is rendered legally void by statute.[4] But neither are creditors prejudiced in their eventual recovery by the collection efforts of other creditors, which are likewise stayed and voided. Because no creditor can obtain an advantage over any other after the filing, no creditor need incur the costs of doing so. Just as the automatic stay polices creditor action after a bankruptcy filing, preference law polices the time before a filing, when the debtor is insolvent but not yet bankrupt. When preference law functions properly, it accomplishes the same ends as the automatic stay: denying creditors the fruits of efforts that serve merely to place themselves ahead of others in the zero-sum division of their insolvent debtor's assets.

Policing preferential transfers is more complex than policing violations of the automatic stay. To enforce the automatic stay, the court merely needs to ask whether an action falls within the scope of statutorily prohibited collection efforts. Such an action, having taken place after the filing, is automatically voided. With preferences, however, a transfer that would otherwise be validly recognized is only retrospectively designated

2 *See, e.g.,* Lawrence Ponoroff, *Bankruptcy Preferences: Recalcitrant Passengers Aboard the Flight from Creditor Equality*, 90 Am. Bankr. L. J. 329, 336 (2016) (quoting a famous phrase from Sir Winston Churchill).

3 A fuller description of our theory can be found in forthcoming co-authored articles.

4 *See* 11 U.S.C. § 362(a).

as a preferential transfer by operation of law because of the bankruptcy filing. Even if all parties recognize that the debtor is insolvent when a seemingly preferential transfer occurs, they cannot know whether the transfer will be avoidable; they must wait to see if the debtor enters bankruptcy during the relevant look-back period (one year for transfers to insiders, 90 days for everyone else).[5]

It is difficult to police creditors' pre-petition, post-insolvency efforts to compete for the debtor's funds because on the surface actions that should be designated as preferential transfers appear identical to completely innocent actions. Under our theory, the sole difference between a preferential transfer and any other pre-petition, post-insolvency transfer is the intent of the parties involved. Avoidable preferences should be limited to those resulting from a creditor's efforts to collect *because* of the debtor's insolvency. Although the creditor may pursue a preference merely to avoid taking a loss, the fact of the debtor's insolvency means that the creditor is not avoiding losses so much as shifting them onto others. This is the behaviour that the law should deter; liability should be cabined accordingly. But intent is hard to prove, more so for preferential transfers than for other laws intended to discourage zero-sum inter-creditor competition, like the automatic stay.

Creditors acting in violation of the automatic stay can be presumed to know of the debtor's insolvency; all should receive timely notice of the bankruptcy from the court, and insolvency is presumed in a voluntary bankruptcy filing.[6] All acts taken to collect against a debtor after the filing can thus be presumed intentional and rendered void. Deliberate violations of the automatic stay, where creditors had actual knowledge of the filing and there is proof beyond presumption of affirmative intent, are subject to additional actual and punitive damages.[7] Creditors are therefore incentivized to take notice of a debtor's bankruptcy filing and refrain from taking actions in violation of the automatic stay because there will be no benefits and real costs from doing so.

But for preference avoidance, knowledge of the debtor's insolvency is more difficult to prove because the action takes place in advance of any bankruptcy filing. A deliberate response to the debtor's insolvency is also more difficult to presume from creditor collection, which is a normal and expected behaviour following the extension of credit. The difficulty of proving the deliberate nature of a preferential transfer explains why an

5 Preferential transfers to non-insiders are defined as those made on or within 90 days before the bankruptcy filing date. 11 U.S.C. § 547(b). Transfers made to insiders while the debtor is insolvent up to a year before the bankruptcy filing may also be avoided as preferences. *Id.*

6 Notice may be provided electronically pursuant to recent amendments to the Federal Rules of Bankruptcy Procedure. *See* Fed. R. Bankr. Pro. 9036.

7 *See* 11 U.S.C. § 362(k).

intent requirement, which was present in the first preference statutes, was eventually abandoned and replaced with the current 'ordinary-course' exception. Our theory puts this history into context and harmonizes the law in a way that other explanations for the purpose of preference law cannot.

Policing preferences is also intractable because the deterrent effect is weak under current rules of enforcement and there are strong incentives for a party who might seek a preference to disregard the possibility of future preference liability. A debtor's insolvency does not always, or even usually, result in a bankruptcy.[8] Even if bankruptcy does follow insolvency, the timing of the bankruptcy is not usually assured or easily predicted. Transfers that occur more than 90 days before the bankruptcy, even if made while the debtor is insolvent, are not avoidable as preferences.[9] This means that most of the time, pressuring a debtor for repayment will have no negative legal consequences.

In fact, preference law's application in bankruptcy proceedings – but only there – presents a dilemma for those creditors who know of the debtor's insolvency. How is an individual creditor to respond? The creditor may wait patiently for the debtor to voluntarily file for bankruptcy. The debtor's bankruptcy would eliminate the creditor's need (and the creditor's ability, because of the automatic stay) to take any action to collect, aside from filing a proof of claim. It would also presumably unwind the preferential transfers given to other creditors who are engaging in a race to recover from the debtor. But if there is no bankruptcy filing, the creditor's patience will ensure that other creditors recover first, leaving less and possibly nothing to satisfy our hapless archetype. If the creditor instead engages in the race for the debtor's assets, the creditor will incur collection costs alongside fellow creditors. If collection is successful and the bankruptcy is never filed, the creditor will be better off collecting than waiting and permitting others to collect first. Thus, creditors are each individually incentivized to join the race to recover from the debtor so long as the debtor remains outside bankruptcy proceedings.[10] A third option might be to file an involuntary bankruptcy

8 Exact numbers of companies that fail outside bankruptcy proceedings are difficult to come by, as are the number of failed companies that were insolvent, but a little back-of-the-napkin math confirms that only a fraction go through bankruptcy. It is commonly estimated that roughly 20% of all American businesses fail in their first year. Going into 2024, there were about 4,500,000 new businesses in the U.S. If estimates are correct, that would amount to 900,000 failed businesses by the end of the year, not including the number of older businesses that also failed. In 2024, there were only 23,107 business bankruptcies filed. Press Release, U.S. Courts, *Bankruptcy Filings Rise 14.2 Percent* (February 4, 2025). Accordingly, the vast majority of businesses failed outside bankruptcy.

9 If the transfer is made to an insider, the preference period is extended to a full year before the bankruptcy filing. *See* 11 U.S.C. § 547(b).

10 For an examination of the effects of preference law on dynamic asset pools using game theory, *see* Barry E. Adler, *A Re-Examination of Near-Bankruptcy Investment Incentives*, 62 U. Chi. L. Rev. 575 (1995).

petition, but this raises its own challenges, including the risk of damages if bankruptcy relief is not granted and the filing harms the debtor's reputation.[11]

Collectively, bankruptcy is the better outcome for creditors when the debtor is insolvent because it provides an orderly system of distribution, saving creditors from incurring duplicative costs in attempting to recover against the debtor individually. Collection costs are likely to be higher when a debtor is insolvent than they would be otherwise, for at least two reasons. First, an insolvent debtor struggling to survive another day will try to conserve its cash and thus be more reluctant to make payments on past debts, requiring creditors to devote more energy to coercing or persuading the debtor to pay up. Second, each individual creditor will inevitably be in competition with other creditors for recovery, due to the debtor's scarcity of funds. Some may win (by being repaid) and some may lose, but all are incentivized to engage in the contest for the debtor's assets. When the costs of the competition are taken into account, creditors are collectively made worse off than if they all had opted for a bankruptcy payout.

Preference law is both reasonable and rational when viewed as a method for reducing creditor recovery costs by discouraging wasteful competitive efforts once the debtor is insolvent, even before the debtor's bankruptcy. More to the point, when described this way preference law is inherently forward looking, even though preference liability relies on a factual determination of past actions. When successful, the deterrent effect of preference law preserves creditor resources and minimizes the losses from insolvency because creditors operating in the shadow of the law will then choose to invest their resources in productive efforts rather than in zero-sum competition with other creditors. However, under the law as currently drafted and enforced, the deterrent effect does not operate as it should. Understanding the purpose for preference law helps to clarify how and why the law falls short in a way that previous literature has not yet accomplished. Preference law can and should be amended to more successfully steer creditors away from collectively wasteful recovery efforts during their debtor's insolvency to more productive pursuits.[12]

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11 *See generally* 11 U.S.C. § 303. For a discussion on the social costs of the reduction in involuntary bankruptcy filings, *see* Richard M. Hynes & Steven D. Walt, *Revitalizing Involuntary Bankruptcy*, 105 Iowa L. Rev. 1127 (2020).

12 As Professor Squire and I explain in a separate work, reforming preference law may also require a broader reformation of other portions of the Bankruptcy Code. Brook Gotberg & Richard Squire, 'The Insecure Creditor's Dilemma' (working paper, on file with the author).

Part I: The Rehabilitative Vision of Bankruptcy Law

The characterization of bankruptcy as a forward-looking endeavour is often received with scepticism by those who know very little about the subject. Perhaps the most common assumption when I mention my field of study to lay people is that it must be 'very depressing'. My inevitable response to this sentiment is to enthusiastically describe bankruptcy as a path to a fresh start, new beginnings and making the best of a difficult situation. But I take the point. After all, the law typically references an 'estate' only when someone dies. Bankruptcy almost inevitably presupposes insolvency, which means that some people (likely many people) must realize a loss when all is said and done. Recognizing this inevitability, bankruptcy works to curtail those losses through adjusting the factors in a simple insolvency equation: recovery is a function of the assets available for collection minus the costs of collecting and distributing them. Bankruptcy seeks to boost the assets available and depress the associated cost of their distribution, thereby lowering overall losses.

In the U.S., the predominant view of bankruptcy is conservative: the law should do as little as possible while still acting in service of core bankruptcy goals. Early on, Thomas Jackson, later joined by Douglas Baird, forwarded the view that bankruptcy should be efficient, reflecting a hypothetical Creditor's Bargain in which all parties are afforded 'the type of contract they would have agreed to if they had had the time and money to bargain over all aspects of their deal'.[13] As a corollary to this idea of efficiency, many have embraced the *Butner* principle, which is that bankruptcy should preserve non-bankruptcy entitlements wherever possible.[14] Presumably, adherence to this provision would itself minimize loss to creditors by preserving efficiently negotiated agreements.

In pursuit of efficiency, bankruptcy law also strives to be frugal, introducing as little additional cost as is necessary to accomplish its purposes. The U.S. Bankruptcy Code asks very little of creditors in making a claim against the debtor's bankruptcy estate, requiring minimal documentation[15] and applying a presumption that a filed claim will be allowed.[16] Claims are regularly estimated for purposes of voting and proposing plans

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13 Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand. L. Rev. 829, 835-36 (1985).

14 *See* Butner v. United States, 440 U.S. 48 (1979). For a criticism of this view of bankruptcy's core purpose, *see* Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 Colum. L. Rev. 1709, 1714-15 (2020) (setting forth a 'New Bargaining Theory' that bankruptcy's proper purpose is to solve a specific contracting failure presented by financial distress).

15 One creditor I interviewed years ago for a research project observed that the proof of claim he paid an attorney to submit 'could have been filled out in crayon'.

16 11 U.S.C. § 502.

of reorganization.[17] Jury trials are rare even in tort cases, where the right to a trial is explicitly preserved by statute.[18] Instead, parties accept accelerated and broadened discovery, quick hearings and settlements. Bankruptcy proceedings thus embrace the concept of 'rough justice' in the interest of minimizing costs.[19]

Commentators tend to assume that a goal of corporate bankruptcy should also be to preserve businesses as a going concern, although this may be an oversimplification leading to a misunderstanding of the basic bankruptcy equation (net payouts = debtor assets – costs of recovery). Certainly, when the business is worth more *to creditors* as a going concern than it would be if liquidated, the law should favour reorganization and rehabilitation as a matter of efficiency. But in cases where the costs of preserving a business will reduce creditors' ultimate payouts, business preservation is not a virtue that bankruptcy should espouse. In this respect, businesses are fundamentally distinct from individuals, who are afforded a 'fresh start' in bankruptcy regardless of their current or future profitability.[20]

Part II: The Confounding Role of Preference Liability

Under its current implementation, the law permitting avoidance of preferential transfers runs contrary to the core bankruptcy principles of conservativism, frugality and business preservation. Under the language of the relevant statute, *any* transfer of an interest in the debtor's property made during the 90 days prior to the bankruptcy filing, when the debtor is presumed to be insolvent, may be unwound and the property or its money's worth returned to the bankruptcy estate.[21] Rather than looking forward to determine how to make the best of the situation and minimize future pain to creditors, the law looks backward, unwinding prior debt payments and thereby inflicting pain on transfer recipients, who become creditors of the bankruptcy estate when the transfer is avoided.[22]

17 *See* Sergio Campos & Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, 91 Fordham L. Rev. 325, 338 (2022) (describing different methods used by courts to estimate claims).
18 *See* Daniel J. Bussel, *The Mass Tort Claimants' Bargain*, 97(4) Am. Bankr. L.J. 685, 698 (2023).
19 *See In re* Tribune Co., 972 F.3d 228, 245 (3d Cir. 2020).
20 *See* 11 U.S.C. § 727(a). Only individual debtors are eligible to receive a discharge in Chapter 7.
21 *See* 11 U.S.C. § 547.
22 Recipients of a preferential transfer must return the value of the property to the estate, even if they are still owed additional amounts by the debtor. 11 U.S.C. § 550. Until this happens, the court will disallow any additional claim of the creditor against the estate. 11 U.S.C. § 502(c).

1. *Preference Liability Introduces New Costs Without Providing New Benefits*

Preference liability is not the only avoidance action in bankruptcy, but it is uniquely problematic compared with other backward-looking bankruptcy rules. Compare the laws on fraudulent conveyance and unperfected liens, two other common avoidance actions. Preference law is more offensive to bankruptcy's conservative approach because it introduces 'new' law rather than simply enforcing non-bankruptcy legal principles. Every state permits a creditor to avoid fraudulent conveyances outside bankruptcy, making this fundamentally a non-bankruptcy right, albeit also enforceable in bankruptcy by statute.[23] Likewise, bankruptcy law invests each trustee, or in Chapter 11 each debtor in possession (DIP),[24] with the rights and powers of a hypothetical lien creditor.[25] A lien creditor can take priority over unperfected liens under state law. Accordingly, the bankruptcy trustee may avoid flawed liens because of state-law rules and only within the parameters of those rules. Preference avoidance has no state-law analogue. There can be no preferential transfer if there is no subsequent bankruptcy filing. Like the automatic stay, it is purely a bankruptcy creation.[26]

Compared to preference actions, other avoidance actions also provide clearer advantages to creditors on a going-forward basis. The recovery of a fraudulent conveyance from a non-creditor provides a benefit to a debtor's creditors as a group because it operates to expand, not merely redistribute, the pot of assets available to them. A fraudulent conveyance may be made to hinder, delay or defraud creditors, but may also be a transfer for which the debtor received less than reasonably equivalent value in exchange.[27] When these 'constructively' fraudulent transfers are recovered, they expand the debtor's assets to a larger degree than they increase the debtor's liabilities. The same is not true for the recovery of preferential transfers, which increase claims against the estate on a dollar-for-dollar basis.

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23 The Bankruptcy Code contains its own statute permitting the avoidance of fraudulent conveyances. *See* 11 U.S.C. § 548. State laws permitting the avoidance of fraudulent conveyances can also be invoked in bankruptcy proceedings. *See* 11 U.S.C. § 544. The Supreme Court has recently held that the Internal Revenue Service, as part of the U.S. federal government, is immune from fraudulent-conveyance actions brought pursuant to state law but not federal law. *See* United States v. Miller, 604 U.S. 518 (2025).

24 The U.S. model permits management to stay in control of a debtor in bankruptcy, acting as the debtor in possession. *See* 11 U.S.C. § 1107.

25 *See* 11 U.S.C. § 544(a). This is commonly called the 'strong-arm' clause. *See* William H. Henning, R. Wilson Freyermuth & Brook E. Gotberg, Understanding Secured Transactions (6th ed., 2024), at 397-98.

26 *See generally* Brook E. Gotberg, *Preferences Are Public Rights*, 2013 Wis. L. Rev. 1355.

27 The transfer is not actually 'fraudulent' as that term is normally understood, because there is no requirement of intent or misdirection. However, a transfer of assets away from an insolvent debtor does prejudice creditors, such that a return of those assets is a clear benefit to them and to the bankruptcy estate.

The trustee's ability to avoid 'secret liens' also provides a benefit to creditors on a going-forward basis, albeit a more tangential one than the financial recovery obtained by avoiding fraudulent conveyances. Secret liens are security interests that have not been properly perfected. Perfection of a security interest is typically accomplished through a form of public notice. The notice gives future creditors the ability to adjust lending decisions in response to the lien; the existence of a security interest removes the collateral in question from the pool of assets that would otherwise be available for unsecured creditors to recover and therefore increases their risk of non-repayment. Creditors who are unaware of a security interest take on the extra risk without compensation, which typically would take the form of higher interest rates. Inability to adjust because of lack of information regarding the security interest then leads to overinvestment by unsecured creditors. Avoidance of secret liens is an enforcement mechanism to encourage the perfection of security interests. The incentive it gives secured creditors to perfect their liens as a precaution against avoidance in the event of bankruptcy gives all other creditors the benefit of additional information about the debtor's financial situation, which allows them to price their credit more accurately.

Preference law does not expand the debtor's available assets; it only claws back pre-petition payments to individual creditors for redistribution through the bankruptcy plan or pursuant to the statutory distribution requirements. There is no legal requirement that the claw-back improve the net payout for other creditors, meaning that a net-neutral preference (where the cost of recovery would equal or even exceed the value of the assets to be recovered) is still avoidable under the statute.[28] This makes it difficult to see any going-forward benefit to creditors in preference avoidance as a rule.

2. *Preference Law Unwinds Non-destructive Transfers*

As explained more fully below, the law permitting preference avoidance is often defended as a way to discourage the premature dismantling of the debtor. Under this

28 Many have expressed frustration and opposition to these sorts of preference actions. *See, e.g.*, Thomas D. Goldberg, *Curbing Abusive Preference Actions: Rethinking Claims on Behalf of Administratively Insolvent Estates*, 23 Am. Bankr. Inst. J. 14 (2004). Opposition to net-neutral preference avoidance may explain exceptions to preference liability for *de minimus* transactions, defined as transfers for less than $600 in consumer cases and less than $7,575 in business cases. 11 U.S.C. § 547(b)(8) and (9). Some have argued that these thresholds should be even higher. *See* Daniel J. Bussel, *The Problem with Preferences*, 100 Iowa L. Rev. Bull. 11, 13 (2014) (suggesting the simplest solution to the unfairness of exposing trade creditors to liability is to raise the limit on preference recovery to $100,000 or more). Others argue that increasing distributions to unsecured creditors is at best a tangential benefit to preference enforcement and oppose the *de minimus* thresholds as undermining the equalizing function of preference law. *See* Ponoroff, *supra* n. 2, at 375.

view of preference law, it is presumed that aggressive collection efforts by individual creditors can reduce the value of the debtor to its creditors by reducing the debtor's ability to operate profitably. And it is certainly possible for a preference to be given (or taken) in a way that damages the debtor's ability to continue as a going concern. For example, the debtor might sell essential equipment to repay a preferred creditor, or a creditor might execute a judgment against the equipment. Either occurrence would reduce the debtor's ability to operate, which could reduce its ability to repay creditors. However, the debtor's voluntary destruction of its own value would logically be a rare occurrence. And an unsecured creditor would likely be unable to shut down a debtor or liquidate its assets without going through costly legal proceedings to obtain and then execute a judgment. Secured creditors have much greater power to liquidate a debtor's assets, but they are generally immune from preference liability because a preference must give a creditor more than the creditor would have received in liquidation without the transfer, and security interests are recognized even in liquidation proceedings.[29] For these reasons, it is difficult to defend preference law as a value-preserving mechanism.

As currently constructed, the scope of preference law is too broad to fulfil the purpose of preserving a debtor's going-concern value. Destructive transfers could be more precisely deterred by narrowing the definition of an avoidable preference to only cover execution of assets by judicial means, or repossession of assets by an under-secured creditor. A debtor's managers would not logically destroy company value by distributing mission-critical assets unless they receive some personal benefit in consequence. Accordingly, there should be no need for preference law to protect estate value by unwinding voluntary transfers, unless they were inadvertent clerical errors or deliberate self-dealing. Even so, management's negligent or self-interested destruction of corporate value should be deterred by other laws enforcing fiduciary duties to exercise care and refrain from self-dealing. But creditors might be willing to destroy a debtor's value if it benefits them, even if doing so hurt other creditors. Accordingly, only involuntary transfers coerced by creditors should be avoided under preference law to achieve the goal of value preservation.

It is not entirely inconsistent with this purported purpose of preference law to apply the law in situations where the debtor cannot be saved, but in most cases, the appropriate goal must be deterring creditors from engaging in future destructive transfers with future debtors. Rehabilitation of the transferring debtor in most cases would likely be a futile goal because the unwinding of a destructive transfer is unlikely to return the going-concern value lost to the estate. For example, if a creditor executed on a debtor's essential equipment 30 days before the bankruptcy filing and promptly sold it for cash,

29 11 U.S.C. § 547(b)(5).

the damage caused by the sale would have been done by the time the preference action is brought. Requiring this creditor to repay the money obtained in the equipment sale will not restore what was really lost – that is, the debtor's ability to continue its operations. In some limited scenarios – where the transfer occurred quite literally on the eve of the bankruptcy, and the preference action is brought before the creditor can liquidate the mission-critical equipment – avoidance of the preference may save the debtor, but these cases are likely to be few and far between.

Preference law is problematically overbroad as a deterrent when applied in cases where the debtor will be liquidated. Under state law, dismantling a corporate debtor is the standard method of recovery for creditors. If preference law is only intended to discourage 'premature' dismantling, it should provide a clearer understanding of how to identify whether and when collection efforts against an insolvent debtor are premature. Without that understanding, creditors cannot know when they should pursue their legal rights to recover and when they should refrain. The concept of prematurity suggests that creditors are expected to wait to collect, but there is no explanation of what they would be waiting for or when the waiting period is over. In the meantime, other creditors could snatch up all the debtor's available assets, leaving nothing for those who wait.

In summary, preference law as written is too broad to be logically understood as an effort to deter only those transfers that will reduce the total value of a debtor's assets by disrupting operations. Its parameters include voluntary transfers by the debtor, which are unlikely to undermine the debtor as a going concern when a debtor's managers are acting rationally. It also includes all involuntary transfers that liquidate the debtor's assets through standard legal procedures, so long as the debtor was insolvent at the time and bankruptcy follows within 90 days. Consequently, the law seemingly deters all collection efforts by unsecured creditors to collect when a debtor does not pay because a creditor could not know whether lack of payment is caused by inability or some other reason, or if a bankruptcy, which would make collection subject to preference avoidance, will follow. By exempting secured creditors' collection efforts from preference liability, the law fails to deter debtor dismemberment by those most likely to accomplish it. Simultaneously, the law goes beyond what is strictly necessary to accomplish its goal when targeting the collection efforts of unsecured creditors. It therefore runs counter to the conservative principles of efficiency that have heretofore characterized U.S. bankruptcy law.

3. *Preference Law Imposes the Costs of Equal Treatment on Creditors*

Commentators may justify the breadth of preference liability – well beyond what would be needed to deter the destruction of the debtor's going-concern value – by pointing to an alternative justification for preference law. The norm of equality among creditors in bankruptcy is established via a rule of pro rata distribution among similarly situated creditors in a Chapter 7 liquidation. Preference law may be seen as a further application of that norm. But there are serious objections to recognizing equality as a value in bankruptcy proceedings more generally and in preference law specifically.[30] When the costs of redistributing wealth among creditors to achieve equality serve to reduce the total recovery for creditors, performing the redistribution is counterproductive and wasteful.

Preference avoidance may be the costliest of the avoidance actions to enforce because the exceptions to preference liability are notoriously ambiguous in application, especially the ordinary-course exception, discussed in greater depth below.[31] These costs are borne by creditors without any collective pecuniary benefit. Instead, wealth is merely transferred from one subset of creditors – the transferees – back to the group, generating litigation costs for both the transferees and the debtor in the process. As the plaintiff in a preference avoidance action, the debtor must dedicate resources to prosecute even a basic, uncomplicated lawsuit. When the debtor is insolvent, every dollar spent chasing a preference comes out of the pot designated for creditor repayment.

A preference lawsuit can also damage the debtor's corporate relationships.[32] Business partners rarely take kindly to being sued, particularly when there is no clear evidence of wrongdoing. Creditors who accept a preferential transfer are unlikely to agree that their action in doing so should result in liability, and they often feel a sense of moral outrage when they receive a demand to return the preference. Consequently, debtors in Chapter 11 may refrain from bringing a preference action against parties with whom they wish to maintain a relationship. The applicable statutory language (the trustee or DIP 'may' avoid preferential transfers) allows the debtor's managers to exercise discretion in pursuing a preference action. It is usually most prudent for those managers to allow core business partners to keep their preferential transfers as a way of preserving important relationships.

30 *See, e.g.,* David A. Skeel, *The Empty Idea of 'Equality of Creditors,'* 166 U. Penn. L. Rev. 699, 702 (2018).

31 11 U.S.C. § 547(c)(2).

32 *See generally*, Brook E. Gotberg, *Relational Preferences in Chapter 11*, 71 Okla. L. Rev. 1013, 1020-21 (2019).

Preference law as it exists today – inefficient, overbroad and costly – runs contrary to the core purposes of bankruptcy. Yet preference actions remain central to U.S. bankruptcy practice, even though conventional arguments for their purpose have proven stubbornly unconvincing. The notion that preference avoidance should enforce an underlying norm of equal treatment for creditors in bankruptcy is one that other scholars have persuasively dismissed.[33] Preference law's efficacy as a deterrent of transfers that destroy going-concern value is limited by its overbreadth.[34] The coexistence of both aims – deterrence of value-destroying transfers and equal treatment among creditors – leads to tension within the law: one calls for targeted application, the other demands universal implementation.[35] It is perhaps no surprise that preference law fails to achieve these goals because of uneven and inconsistent enforcement. The next section explores the reasons for this failure in greater detail.

Part III: The Predicament of Imposing Preference Liability

Like many others who have noted the flaws in preference avoidance enforcement,[36] I have authored scholarship advocating changes to limit the costs the law imposes on creditors. But that scholarship was written on the assumption that the historically identified objectives for preference law were the law's true purposes, an assumption Squire and I reject in our forthcoming work.[37] Legislative history associated with the 1978 U.S. Bankruptcy Code identified two reasons for preference avoidance: promoting equality among creditors and deterring the premature dismantling of the debtor. As explained below, neither gives a satisfactory explanation for preference law as written in the Code itself or as currently enforced.

Most literature on preference law's anti-dismantling purpose views it as a secondary consideration, and it is so described in the legislative history for the 1978 U.S. Bankruptcy Code.[38] This history explains:

33 *See, e.g.,* Skeel, *supra* n. 30, at 704 ('The equality principle should be abandoned').

34 *See, e.g.,* John C. McCoid II, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 Va. L. Rev. 249, 263-64 (1981).

35 *See generally*, Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 Iowa L. Rev. 51 (2014).

36 *See, e.g.,* Bussel, *The Problem with Preferences*, *supra* n. 28 (recommending limitations on preference liability); Ponoroff, *supra* n. 2 (condemning amendments that broadened the ordinary-course exception); Charles Jordan Tabb, *Rethinking Preferences*, 43 S.C. L. Rev. 981 (1992) (recommending repeal of the ordinary-course exception).

37 See note 12 above.

38 *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-79 (1977).

> The purpose of the preference § is two-fold. First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy. The protection thus afforded the debtor often enables him to work his way out of a difficult financial situation through cooperation with all of his creditors. Second, and the more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. The operation of the preference § to deter 'the race of diligence' of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference § – that of equality of distribution.

Preference law falls short of both purported purposes.

1. Equality and Anti-Dismemberment at Cross-Purposes

The House report suggests that preference law should deter creditors from imposing costs on a struggling debtor – particularly the costs of 'dismemberment' that may arise when creditors execute on a debtor's individual assets. Implicit in this framing is the assumption that preference law works to ensure that a debtor remains intact. Dismemberment prevention would therefore seem to have no place in liquidation proceedings, except as a prophylactic measure in cases where it is unclear if reorganization will be possible. Further, as a negative inference, transfers that do not threaten the viability of the debtor should be permitted to stand.

But preference law does operate in Chapter 7, and it does target transfers that were harmless in terms of the debtor's going-concern value, in apparent pursuit of its 'more important' goal – equality of distribution among creditors. The equality principle is one that many scholars return to frequently as an explanation of bankruptcy law's motivating purposes. The Supreme Court has even embraced equality between creditors as 'the ultimate aim of the Bankrupt Law'.[39] In addition to being 'more fair' for creditors, the equality principle is justified on the assertion that 'creditors will be more willing to lend if they are confident that they will receive equal treatment,'[40] making equality the most beneficial structure for debtors as well.

39 Clarke v. Rogers, 228 U.S. 534, 548 (1913).

40 Skeel, *supra* n. 30, at 707 (citing 15 Cong. Rec. 2962 (1884) (statement of Rep. Hoar)).

As a motivating principle of preference law, equality is relatively new. Although prohibitions on preferential transfers appear as early as 1841,[41] for most of its history preference liability has required proof of intent, either on the part of the debtor or the creditor. The intent requirement was abolished in the 1978 Code on account of the difficulty of proof,[42] creating a standard of strict liability for preferences that would nominally apply to all recipients.[43] Presumably, this also promoted a more equal distribution among all creditors.

But equality may not serve as strong a role as has been suggested. Professor David Skeel has written an insightful piece on the equality principle in bankruptcy. His work observes that current bankruptcy law has effectively abandoned the principle – to the extend it had ever embraced it – by providing 'numerous devices for privileging one creditor or group of creditors over others'.[44] As a non-comprehensive list, he points to a debtor's ability to accept or reject executory contracts, designate certain creditors as 'critical vendors' to be paid in full, and give special treatment through sales agreements.[45] This general pattern of sacrificing the interests of equality to accomplish alternative bankruptcy purposes carries into the realm of preferential transfers.

The goal of ensuring equality among creditors through enforcing preference liability is undercut by exceptions to liability, which would allow some transactions to stand even while unwinding others. The most controversial exception is for 'ordinary-course' payments. This exception (and others) may be defended under the baseline doctrine of repose – commercial transactions should be treated with finality wherever possible and the law should only avoid transactions when necessary to fulfil its purposes. If the purpose of preference law is to deter the premature dismantling of the debtor, the law should only avoid transfers that effect this dismantling. As explained in greater depth below, the standard for ordinary-course payments has suffered from crippling opacity in its application. But at the very least, the legislative history of the law suggests that its purpose was to distinguish between those transfers that may undermine the debtor's ability to continue functioning and those that represent 'normal financial

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41 *See* An Act to Establish a Uniform System of Bankruptcy Throughout the United States, ch. 9, 5 Stat. 440 (1941) (repealed 1943).

42 *See* H.R. Rep. No. 595, 95th Cong., 2nd Sess. 178 (1978), *reprinted in* 19789 U.S.C.C.A.N. 5963, 6139.

43 *See* Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 Wis. L. Rev. 1439, 1477-78 (1993) (describing the move away from a culpability standard as an evolutionary process).

44 Skeel, *supra* n. 30, at 714 (noting that equality of creditors is easily evaded in practice). Many scholars resist the apparent abandonment of the equality principle. *See, e.g.,* Ponoroff, *supra* n. 2, at 350 (condemning amendments that come at the expense of the bankruptcy goal of equality); Tabb, *supra* n. 36, at 994 ('Equality is fairer and more equitable, it is more efficient, it makes more logical sense, and it is simpler and easier to administer than fault-based theories of preference recovery.').

45 Skeel, *supra* n. 30, at 716-18.

relations' with the debtor. The first set of transfers should be unwound, and the second should stand.[46] The ordinary-course exception thus embraces the anti-dismemberment purpose of preference, at the expense of the equality purpose.

A fundamental characteristic of equality is that it must be applied universally. By definition, the introduction of any exception undercuts equality,[47] and so a law seeking equality can serve no other goal. This explains why those who embrace the equality purpose of preference law would repeal the ordinary-course exception altogether.[48] By the same logic, however, many other current limitations on preference avoidance would have to be removed as well. If our primary concern is that all general unsecured creditors are treated equally, why limit the look-back period to 90 days, or avoid only those transfers made when the debtor was insolvent? And why does the law permit some flexibility in providing different distributions to different classes of creditors in bankruptcy reorganizations?[49] It might therefore be said that preference law fails to ensure equality because bankruptcy law more generally fails to ensure equality.

In practice, the two purported aims of preference law work at cross-purposes. The first, equality, implies a system of strict liability regardless of creditors' intent or conduct. The second, anti-dismemberment, is best accomplished by distinguishing among creditors to deter problematic creditor behaviour while permitting normal creditor-debtor interactions. In seeking to advance both purposes, the law achieves neither satisfactorily.[50] My earlier work urged abandonment of the anti-dismemberment goal in favour of a single, coherent objective: promoting equality among unsecured creditors.[51] Because that aim can be meaningfully pursued only in bankruptcy liquidation proceedings, I recommended against enforcing preference actions in Chapter 11 reorganizations, where preservation of the debtor has proved more important than ensuring strict equality of repayment.[52] I have since abandoned that recommendation in favour of the approach Squire and I have developed, but the problem prompting it remains: the two most commonly accepted purposes of preference law are fundamentally at odds.

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46 H.R.Rep. No. 595, 95th Cong., 1st Sess. 373-74 (1977), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 6329.

47 This principle is artfully underscored in George Orwell's satirical parable, *Animal Farm* (1945). As told in the story, the farm animals' socialist uprising begins with their adoption of a central tenet, 'All animals are equal.' Bit by bit, this and other sacred principles are whittled away by the pigs, who are corrupted by power. Eventually, the phrase is altered to 'All animals are equal, but some are more equal than others.'

48 *See* Ponoroff, *supra* n. 2, at 391 ('I would not lose a moment's sleep or shed a single tear if the ordinary course of business defense were to be repealed tomorrow[.]'); Tabb, *supra* n. 36, at 986.

49 The relevant requirements permit a plan to discriminate if creditors vote in classes to accept the plan. If creditors do not accept the plan, it may still provide different treatment among creditors so long as it does not 'discriminate unfairly'. *See* 11 U.S.C. § 1129(a) and (b).

50 *See* Gotberg, *Conflicting Preferences*, supra n. 35.

51 *Id.*, at 59.

52 *Id.*, at 88.

2. *Ineffective Dismemberment Prevention*

Preference law's ability to discourage creditors from dismantling debtors is doubtful, at least under current practices.[53] Much of the difficulty arises from lack of fit between what the statute does and the purpose ascribed to it. The language of the statute encompasses all transfers from debtor to creditor, with some notable exceptions for payments made in the ordinary course and payments followed by the extension of new credit (the 'new value' exception).[54] These exceptions were introduced with the 1978 Code, replacing the previous requirement that a preference had to be received by a creditor with knowledge – or reasonable cause to know – of the debtor's insolvency.[55]

But the legislative history suggests that only those transfers that might threaten the debtor's 'premature dismantling' should be targeted. As explained above, most preferential transfers could not reasonably be considered a threat to the debtor's ongoing survival, which makes the law exceedingly overbroad on its terms. The ordinary-course exception could be interpreted as covering all transactions but those that would dismantle the debtor, but such a reading would be forced, particularly in light of a Supreme Court holding that large, enterprise-threatening transfers can qualify for the exception if made pursuant to a previously set schedule.[56] On the flipside, payments that do not harm a debtor's going-concern prospects but are made at unusual times or under unusual circumstances are not made in the ordinary course, at least as 'ordinary' is generally understood, and are therefore subject to avoidance. The law thus fails to target the behaviour it wishes to deter, with the ordinary-course exception being both too narrow and too broad in application. Without a clear understanding of what behaviour is problematic, creditors cannot realistically adjust their behaviour in response to the law.

Nor are creditors incentivized to adjust their behaviour, because seeking a preferential payout remains the most profitable option when the debtor is insolvent. As an initial matter, there is no guarantee that an insolvent debtor will ever file for bankruptcy. Without a bankruptcy, there is no preference law and no preference avoidance. Accordingly, it is wise for a creditor to recover quickly; by waiting, the creditor risks forfeiting any chance of repayment if other creditors act first and exhaust the debtor's remaining assets.

53 Brook E. Gotberg, *Optimal Deterrence and the Preference Gap*, 2018 BYU L. Rev. 559 (2018).
54 11 U.S.C. § 547(c)(2) and (4).
55 *See* Tabb, *supra* n. 36, at 1008-09.
56 *See* Union Bank v. Wolas, 502 U.S. 151 (1991).

Even if bankruptcy does follow, the only penalty for having received a preferential transfer is that the preference must be returned.[57] And a full return of the preference is truly a worst-case scenario for creditors because, rather than go through the process of litigating, most DIPs and trustees will settle with preferred creditors for a fraction of the total avoidable sum. Settlement is even more common when there are potential defences to preference liability, and there nearly always are. The foremost defence, available to nearly every creditor due to the breadth of its interpretation, is the aforementioned ordinary-course exception.[58] Courts have not settled on a uniform understanding of the exception – it may be defined to include transactions that do not harm the debtor or transactions that are not unusual between the debtor and the creditor or transactions that are not unusual within the industry – and legislative history only confuses rather than clarifies its scope. With the possibility of defences, settlement of a preference claim may frequently be in the best interests of the bankruptcy estate. When expected liability is discounted to account for the possibility of settlement, many creditors who must expend efforts to obtain the preference from the debtor in the days leading up to bankruptcy will still see those efforts as worthwhile investments in present-value terms.

Consider the following hypothetical scenario. Debtor owes Preferred Creditor $100. Preferred Creditor learns of Debtor's insolvency and pressures Debtor for repayment.[59] Preferred Creditor expends $15 in its pressure campaign and is ultimately successful – Debtor pays Preferred Creditor the full $100. Debtor then files for bankruptcy within 90 days of the repayment. Having paid Preferred Creditor, Debtor's remaining assets are only sufficient to pay other creditors 10 cents on the dollar. If Debtor had not paid Preferred Creditor, the assets would have permitted a payment to all creditors of 12 cents on the dollar. In the bankruptcy, Debtor sues Preferred Creditor to avoid the transfer. If Debtor is successful, Preferred Creditor will return the $100, and all creditors (including Preferred Creditor) will be paid 12% of their claims. Preferred Creditor will be worse off by virtue of having sought the preference – it will have expended $15 without realizing any net increase in its recovery. The creditor's net recovery is a negative $3, when no action would have resulted in a positive $12 return.[60]

57 Gotberg, *Optimal Deterrence, supra* n. 53, at 559.

58 *See* 11 U.S.C. § 547(c)(2); Gotberg, *Optimal Deterrence*, *supra* n. 53, at 598-99.

59 Such a low dollar amount would not be recoverable as a preference under 11 U.S.C. § 547(c)(8) and (9), which establish exceptions for *de minimus* transfers. Low, round numbers are used for the benefit of simplicity in this model.

60 This calculation presupposes that the $100 loan to an insolvent debtor is a sunk cost and therefore not a relevant variable in the creditor's calculation.

Stopping the analysis there, Preferred Creditor will be deterred from expending resources to obtain the preference but not from passively accepting a preference. If Preferred Creditor had not expended resources to receive the $100 payment, then requiring Preferred Creditor to later return the payment to Debtor's estate leaves Preferred Creditor no worse off (unless perhaps the requirement to return the $100 payment causes a liquidity problem because Preferred Creditor spent it on receipt). Preferred Creditor might even be better off having accepted the preference and then returning it later due to the time value of money; in such a case the payment functions like a zero-interest loan.

Furthermore, Preferred Creditor will only be deterred from expending resources to collect if Preferred Creditor assumes that preference liability will follow the transfer. A bankruptcy is far from a certain outcome at the time a preferential transfer is made. Most insolvent firms do not file for bankruptcy; instead, they surrender their assets to creditors voluntarily or through state-court proceedings. If Debtor is insolvent but never files for bankruptcy, Preferred Creditor's push for repayment will ensure that Preferred Creditor is better off than Debtor's other creditors, who are vying for the same assets. Even if there is a bankruptcy, not all preferential transfers are pursued. A debtor is much less likely to pursue transfers made to creditors whose ongoing cooperation is deemed vital to the debtor's survival. But if Preferred Creditor knows there will be a bankruptcy and also that preferential transfers will be targeted for liability, Preferred Creditor might choose not to expend the resources to pursue payment. If Preferred Creditor must return the full amount of the preference, doing so is a losing proposition.

But a well-advised creditor/transferee would never simply return the full amount of the preference in response to an avoidance action. Instead, the transferee would negotiate a settlement. As noted above, a party faced with a preference complaint can almost invariably raise a defence to preference liability that would need to be litigated before judgment is ordered. The debtor's potential costs of pursuing judgment for the preference and then executing on that judgment will usually induce the debtor to settle instead. Whether represented by a trustee, as in Chapter 7, or acting through its managers, as in Chapter 11, a debtor will prefer not to expend resources on litigation and collection. Instead, the debtor will accept less than the full amount of the transfer in satisfaction of the preference claim.

The decision to settle – and for how much – will be flavoured by the trustee/DIP's personal incentives. The trustee is paid on a contingency, receiving a percentage of what is recovered. The trustee is therefore highly motivated to pursue preferences, but not to litigate them, because the trustee's marginal benefit will decrease significantly the more effort that must go into recovering the preference. A DIP will have distinct priorities regarding its relationship with transferees, as described in greater depth below, and those priorities are unlikely to be perfectly aligned with creditors' interests when it comes to preference avoidance. Settling for less than the full amount owed will allow the transferee – at a minimum – to recuperate whatever costs of collection the transferee may have incurred in chasing the preference. More likely, the transferee can settle for a sufficient sum to be better off for having received the preference.

Returning to our hypothetical scenario, imagine that Preferred Creditor responds to Debtor's demand to return the preferential transfer by hiring an attorney and putting up a full defence. If Debtor wishes to recover, Debtor must expend resources to counter Preferred Creditor's defence. Those resources will come from funds that would otherwise go to reorganization (in Chapter 11) or distribution to creditors (in Chapter 7). Debtor and Preferred Creditor will likely negotiate a settlement amount that will satisfy both parties' interest in avoiding litigation.

There is ample room to reach a settlement agreement. Preferred Creditor's alternative to settlement is to return the entire preference or to expend additional resources trying to avoid liability. A successful defence to preference liability is unusual, assuming all core elements are present. Preferred Creditor should therefore agree to anything that will reduce the amount to be returned to the Debtor, especially if settlement does not require the dedication of further resources. Debtor's alternatives when Preferred Creditor brings a defence are to litigate, expending resources to recover the preference, or to drop the lawsuit altogether and recover nothing. Debtor's maximum return will be the amount of the preference minus the costs of the litigation.

Both sides are incentivized to minimize the additional resources they expend on preference defence or recovery. Under our hypothetical scenario, if we assume that Preferred Creditor must spend an additional $5 to raise a preference defence, Preferred Creditor will be better off having pressured Debtor for the preference so long as the parties settle for less than $68. Debtor will be better off recovering anything that exceeds its own litigation costs, which we might also assume come to $5. The zone of possible agreement is considerable – anything over $5 and under $68 is a good outcome for both parties.[61] Settlement within that zone will ensure both are better off than the alternatives. It will also ensure that Preferred Creditor is better off for having pursued the preference, eliminating any purported deterrent effect of the law.

61 As noted above, absent a strong defense, Preferred Creditor should rationally accept any offer of settlement below a full repayment to minimize losses, which expands the zone of mutually beneficial settlement amounts all the way up to $100. But Preferred Creditor can typically leverage the Debtor's desire to avoid litigation to decrease the total settlement amount.

Hypothetical Outcomes for a Would-Be Preferred Creditor

	Claim	Recovery Costs	Preference Received	Preference Returned	Bankruptcy Payout	Ending Net Position
Preference – No Bankruptcy	($100)	($15)	$100	$0	–	($15)
No Preference – Bankruptcy	($100)	$0	$0	$0	$12	($88)
Preference – Full Liability	($100)	($15)	$100	($100)	$12	($103)
Preference – Litigated Settlement	($100)	($20)	$100	Up to ($68)	–	($88) at worst

Empirical research supports these logical conclusions. Both quantitative and qualitative studies confirm what most practitioners already know – preference litigation is dominated by settlement agreements, many executed before a complaint is even filed. The average settlement discount is less certain, but rough estimates are that meritorious claims typically settle for about half of the total transfer amount.[62] At those rates, the threat of preference liability is unlikely to provide a meaningful deterrence to creditors, even when they must expend resources to obtain the preference and even if preference liability is sure to follow the transfer.

Best evidence also confirms that liability is not inevitable if the debtor is in Chapter 11. Qualitative studies support the theory that debtors acting as DIPs differentiate among creditors when it comes to bringing avoidance actions, only targeting those who are unimportant to the debtor's ongoing success.[63] In this way, selective preference avoidance functions to *perpetuate* preferential treatment among unsecured creditors, much like critical vendor motions, but without as much judicial oversight.[64] In a critical vendor motion, the DIP seeks court approval to repay a subset of unsecured creditors in full outside the plan of reorganization to ensure their ongoing cooperation.[65] With discriminatory preference avoidance, the debtor may do effectively the same thing – paying the preferred subgroup of creditors before the bankruptcy rather than after – as long as no one objects. Objections to a decision not to pursue a preference are rare.

62 *See* Gotberg, *Optimal Deterrence*, *supra* n. 53, at 599, n. 143.
63 *See generally* Gotberg, *Relational Preferences*, *supra* n. 32.
64 *Id.*, at 1060.
65 For an influential condemnation of critical vendor recognition, *see In re* Kmart Corp., 359 F.3d 866 (7th Cir. 2004).

3. *Irresolvable Tension in the Currently Accepted Purposes for Preference Law*

Preference liability fails to ensure equality of treatment among creditors and does not meaningfully deter preference seeking by creditors who are sophisticated enough to negotiate a settlement. In practice, preference avoidance actually serves to perpetuate rather than eliminate unequal treatment among creditors. Those who are targeted with preference liability must invariably view it as a capricious, pointless, costly imposition: another indignity accompanying the debtor's insolvency and bankruptcy. As one attorney put it, his advice to creditors is to not think of preference liability as a matter of fault, but rather as a matter of timing.[66] Little wonder that creditors invariably bristle at preference avoidance and debtors' counsel speak of it with some chagrin.

Lack of a coherent vision for preference law complicates efforts at reform. As part of the 2019 amendments to the Bankruptcy Code that created subchapter V of Chapter 11,[67] Congress amended the preference statute to condition a trustee's ability to bring a preference action 'on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses'.[68] It was hoped that this language would induce bankruptcy trustees to conduct a more thorough review of preference liability before seeking avoidance, which would presumably reduce the total number of preference actions brought and especially decrease the number of litigable cases. But the language of the statute was too vague to effect any serious changes to practice, particularly as bankruptcy trustees were already constrained from filing claims they knew were not 'warranted' or lacked 'evidentiary support' after conducting 'an inquiry reasonable under the circumstances'.[69] Subsequent judicial interpretation of the provision has demonstrated its ineffectiveness.[70]

66 Gotberg, *Optimal Deterrence*, *supra* n. 53, at 572, n. 33.

67 *See* Small Business Reorganization Act of 2019, Pub. L. No. 116-54, § 3, 133 Stat. 1079, 1085 (codified at 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.). At the time of this writing, subchapter V is available to debtors with ongoing business or commercial activities and debts below about $3 million.

68 11 U.S.C. § 547(b).

69 Fed. R. Bankr. Pro. 9011. *See also* Brook E. Gotberg, *Poking at Preference Actions: SBRA Amendments Signal the Need for Change*, 28 ABI L. Rev. 285 (2020).

70 There was some early litigation questioning whether the amendment introduced a new element into the law, which must be pled to prevent dismissal of the underlying complaint. In one case, the court did find that due diligence and consideration of affirmative defences constituted an element of the trustee's prima facie case, requiring the court to dismiss a complaint in which those elements were not pled. *See In re* ESC Refining, Inc., 625 B.R. 425, 457 (Bankr. E.D. Cal. 2020). The court gave the trustee leave to amend the complaint. *Id.*, at 461. When the issue arose in other cases, it had no impact on the outcome. *See In re* Center City Healthcare, LLC, 641 B.R. 793, 802 (Bankr. D. Del. 2022) (concluding that even if the statutory amendment inserted a new element to preference claims, the complaint had adequately pled factual allegations to satisfy that element); *In re* Liquidating Estate of H&P, Inc., 648 B.R. 767, 792 (Bankr. W.D. Penn. 2023) ('Even assuming the Plaintiff was under some sort of due diligence standard akin to the one currently appearing in section 547(b), the Court would find the standard was met.').

The recent effort at reform does highlight a major concern with preference liability – if we cannot agree why it exists, and we recognize that it imposes high costs on both the debtor and the creditor, the inescapable conclusion is that we should have less of it, if any at all. Yet preference avoidance continues to be applicable in every chapter of the Bankruptcy Code – liquidation and reorganization, individual and corporate – and it continues to play a role in a large percentage of bankruptcy cases. Tangential efforts to constrain its scope are unlikely to have any meaningful benefit. What is needed is a more complete understanding of the reasons for avoiding preferential transfers, along with revisions to the Code to bring the law into harmony with those reasons. If there is no good reason, there should be no law.

Part IV: Preference Law Looks Forward

There is a good reason to enforce preference law, but it is not one recognized in the Code's legislative history or in prior scholarship on preference law. As described above, the primary purpose of business bankruptcy law is to minimize the losses caused by inter-creditor conflict during or in anticipation of a debtor's insolvency. Just as the automatic stay deters creditors from engaging in this competition after a bankruptcy filing, Squire and I argue that preference law seeks to deter competition for collection in the days leading up to bankruptcy when the debtor is insolvent.

The purpose of a properly designed law of voidable preferences is to deny creditors the fruits of their efforts to collect ahead of other creditors when their common debtor is insolvent but not yet bankrupt. When the debtor is insolvent, any resources that creditors expend trying to recover first are collectively wasteful, as they merely shift losses from those who obtain preferential payouts to those who do not. Gross recoveries are the same, but net recoveries are lower due to the loss-shifting expenditures. The law can spare creditors the costs of such zero-sum collection efforts by assuring them that anyone who spends resources trying to obtain a payout that exceeds a bankruptcy-allotted share of the debtor's assets will have to give it back.

The problem of wasteful inter-creditor competition is largely distinct from the notion that bankruptcy should preserve equality among creditors, although the two are related. Forced equality is its own type of deterrent against competition. There is no point (and no benefit) to competing with other creditors if all will receive the same pro rata payout at the end of the day. But we reject the characterization of preference law (or bankruptcy law more generally) as a means to ensure equal treatment for equality's sake. If an insolvency proceeding did nothing to ensure equality, but instead simply dictated the terms of the distribution – for example, some creditors might be paid more than others, as by a lottery system where no creditor can influence the outcome – the distribution would still satisfy our understanding of the purpose of bankruptcy proceedings because it would minimize the cumulative losses from inter-creditor competition, even if some creditors suffered greater losses than others. As compared to non-bankruptcy proceedings, where creditors would expend time and money jockeying for payment from the debtor and thus reducing the sum of their net recoveries, even an unequal distribution is an improvement. There may be other economic reasons to prefer the default of pro rata distribution, but in our view, equality of distribution in bankruptcy is not a virtue unto itself.[71]

Preference liability can discourage inter-creditor competition for an insolvent debtor's assets by removing the benefits of winning. Under non-bankruptcy law, creditors recover from a debtor under principles of first in time, first in right, so that early collectors recover in full while latecomers usually get nothing. Accordingly, when a debtor is insolvent outside bankruptcy, all its unsecured creditors are incentivized to compete in a race for its assets. Creditors may compete by currying the debtor's favour or by threatening the debtor. Likewise, creditors may compete to recover their full claims at the expense of other creditors, or simply to protect their own pro rata share of available assets. Either approach requires an expenditure of resources that reduces creditors' combined net recoveries, and all such efforts should therefore be discouraged.

This explanation differs from the conventional view that preference law should serve an anti-dismemberment purpose. On that view, preferential payments should be discouraged only when they would disrupt the debtor's operations and thus reduce its going-concern value. By contrast, Squire and I believe that the purpose of preference law is to deter creditors from imposing costs, not on the debtor as such, but rather on themselves when they compete for superior positions in the payout queue. This zero-sum competition always imposes costs on creditors, whether the debtor should be reorganized or liquidated and regardless of whether the race would force a 'premature' dismemberment. Under our theory, the law should discourage creditors from engaging in the race not just to preserve the value of the debtor's estate, but also for their own sakes. Put another way, while preference avoidance is justified under the anti-dismemberment rationale only if a creditor race would harm creditors by reducing the *gross* value of the debtor's assets, our rationale applies whenever the creditor race would harm creditors by reducing their *net* recoveries.

It is core to our understanding of preference law and bankruptcy more generally that successful bankruptcies include liquidation cases. Some liquidation is inevitable;

71 *See also* Skeel, *supra* n. 30, at 742 ('In bankruptcy, the equality norm has all of the downsides that equality has in other contexts, with none of its ostensible virtues.').

corporate liquidation proceedings outnumber reorganizations in the U.S. by roughly 50% year over year.[72] It may also be the desired outcome. In cases where the assets are worth more when sold piecemeal, debtor dismemberment is the best means to creditor recovery. With this in mind, we do not consider preference law a tool to facilitate a debtor's reorganization, although that may be a happy side effect in some cases. Instead, preference liability should function to discourage creditors from engaging in mutually destructive competitive efforts, which cumulatively make all society worse off.

Conclusion

Professor Larry Ponoroff has authored many careful and thoughtful treatments on preference avoidance. As he has observed,

> [f]rom the beginning, it seems, our approach to preference legislation has been consistently plagued by the lack of a single, unified, and reasonably enduring answer to the question of, 'so why a preference law?'[73]

Ponoroff believes that the answer to this question is the preservation of equality among creditors. On this basis, he would eliminate exceptions to preference liability such as the ordinary-course-of-business defence.[74] Other scholars, such as Professor Daniel Bussel, have embraced preference law's conventional anti-dismemberment theory and would limit preference liability to cases where recipient creditors are not 'basically innocent' but instead are engaged in 'express opt-out behavior' that is socially destructive because it 'threatens to destroy the possibility of reorganizing an otherwise viable business'.[75]

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72 In 2024, there were 12,582 business cases filed under Chapter 7 and 8,456 filed under Chapter 11. *See* Table F-5A, U.S. Bankruptcy Courts – Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code, District, and County – During the 12-Month Period Ending December 31, 2024. In 2023 the relevant numbers were 10,229 business Chapter 7 cases and 7,070 Chapter 11 cases. Table F-5A, U.S. Bankruptcy Courts – Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code, District, and County – During the 12-Month Period Ending December 31, 2023. In 2022, Chapter 11 cases were down even further, with 7,728 Chapter 7 cases and only 4,465. Table F-5A, U.S. Bankruptcy Courts – Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code, District, and County – During the 12-Month Period Ending December 31, 2022.

73 Ponoroff, *supra* n. 2, at 390.

74 *Id.*, at 391. Ponoroff is not alone in this belief. *See* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 776 (1985) ('In view of the feeble inspiration for this exception, and because the exception is completely at war with the concept of a preference and has no rational confining limits, the best future for present section 547(c)(2) is repeal.'); Tabb, *supra* n. 36, at 984.

75 Bussel, *The Problem with Preferences*, *supra* n. 28, at 12-15.

Under this logic, Bussel advocates for more extensive exceptions to preference liability as a way to sift 'good' preferences from 'bad' ones.[76]

As described above, Squire and I view preference law as neither a means to ensure equality among creditors nor as a method for facilitating debtor rehabilitation, although both can happily be secondary consequences. Equality of treatment – like any set, unalterable distribution – can serve to ensure that creditors experience no benefit in competing for an insolvent debtor's assets on the cusp of bankruptcy. Methods of collection that reduce the debtor's going-concern surplus should of course be deterred, but so should all other wasteful efforts at collection. Our explanation encompasses other proffered theories for preference law and provides a defensible basis for both its historical intent requirement and its modern exceptions.

Preference avoidance, despite being backward looking in nature, is a method of shaping creditor incentives when dealing with an insolvent debtor to encourage the productive use of resources and discourage wasteful zero-sum competition. As such, it is also inherently forward looking – it encourages creditors to move beyond wasteful squabbling over a debtor's limited assets and, instead, to invest their resources in more socially productive outcomes. In this way, it discourages a preoccupation with old, uncollectable debts. This revised understanding of preference law reaffirms its validity and usefulness in both reorganization proceedings and liquidations.

76 This terminology is borrowed from Professor Charles Tabb, another prolific scholar on the subject of preference avoidance. *See* Tabb, *supra* n. 36, at 982.

English Restructuring Law: Full Steam Ahead or a Glance in the Rear-View Mirror?

Sarah Paterson[*]

Before the 2000s, large companies typically restructured out of court in the UK. Several factors, however, steadily made the bargaining environment more difficult, including the breakdown of norms that constrained strategic behaviour in restructuring negotiations, the increase in the number of players and the diversity of their interests and, relatedly, the rise of complex, highly leveraged capital structures.[1] As a result, and in common with much of Europe and the US, most of the focus since the early 2000s has been on whether the law supplies the right tools to solve these bargaining frictions, so that firms can restructure and return to profitability. There is a danger, however, that we begin to see restructuring as an inviolable good, and lose sight of the fact that we cannot, and should not hope to, restructure every company that runs into difficulty. This report investigates a specific issue within this broad concern: the extent to which restructuring results in the loss of valid claims against the company or the directors to avoid transactions entered into in the run-up to financial distress.

1 The English Transaction Avoidance Regime

1.1 A Brief Overview of English Transaction Avoidance

We should start with a brief overview of the English transaction avoidance landscape to anchor our analysis. The first relevant tool is the transaction at an undervalue regime. This permits an administrator or liquidator to apply to court for such order as the court thinks fit to restore the position to what it would have been if the company had not entered into the transaction at an undervalue.[2] A transaction will be at an undervalue if the company makes a gift for no consideration or receives significantly less consideration than the value of the consideration that it provides. The vulnerability

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1 For a detailed account see Sarah Paterson, 'Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards' (2014) 14(2) Journal of Corporate Law Studies 333 and Sarah Paterson, *Corporate Reorganization Law and Forces of Change* (OUP 2020).

2 Insolvency Act 1986, s. 238.

period is two years, starting with the onset of insolvency,[3] and the company must have been unable to pay its debts at the time of the transaction or become unable to pay its debts as a consequence of it (presumed if the transaction was with a connected party). A defence is also available – that the company entered into the transaction in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

The second tool is the preference regime.[4] Once again, the application is made by an administrator or liquidator and once again the company must be or become unable to pay its debts (which is not presumed for connected parties in this case). A company gives a preference to a person if that person is a creditor or surety or guarantor of the company's liabilities and the company does anything or suffers anything to be done that has the effect of putting that person in a better position than if the thing had not been done, assuming insolvent liquidation. Crucially, however, no order will be made unless the company giving the preference was influenced in deciding to give it by a desire to produce the preferential effect (which is presumed if the parties are connected). The challenge period is six months before the onset of insolvency or two years if the parties are connected.[5] There is also a specific regime for setting aside floating charges,[6] and a specific regime for extortionate credit transactions,[7] both available in administration or liquidation. Finally, section 423 of the Insolvency Act 1986 enables an administrator, a liquidator, or a victim of the transaction to bring a claim that the company entered into a transaction at an undervalue for the purposes of putting its assets beyond the reach of current or future creditors.[8] Readers may recognise the contours of what became known in Roman law of the *Actio Pauliana*, available both inside and outside insolvency proceedings.

1.2 Transaction Avoidance Tools and Insolvency Procedures

As we have seen, with the exception of section 423 claims, England's transaction avoidance regime is only engaged if the firm enters administration or liquidation. There are two ways in which administration may be relevant in a restructuring context. First, administration offers a moratorium, which could be used to create a breathing space

3 Ibid., s. 240(1)(a).
4 Ibid., s. 239.
5 Ibid., s. 240 (1)(a) and (b).
6 Ibid., s. 245.
7 Ibid., s. 244.
8 Where the company is in administration or liquidation a victim of the transaction requires leave of the court to bring a section 423 claim – see Insolvency Act 1986, s. 424(1)(a). In all other cases, a victim of the transaction can bring a claim without leave – see s. 424(1)(c).

within which restructuring negotiations could be carried out. It does not, however, offer tools to reduce the levels of consent necessary for a restructuring to be agreed from those provided for in the relevant contracts. For this, the firm must turn to different tools in the English law toolbox: the Company Voluntary Arrangement (CVA), the scheme of arrangement, or the Part 26A restructuring plan procedure.

In an administration, a regulated office holder (known as the administrator) is appointed to the firm. The administrator has broad powers to manage the firm's business and can dismiss or replace directors. While it is possible for the administrator to decide to leave powers of management with the directors, it is the administrator who controls that decision.[9] This is an unattractive loss of control for directors contemplating administration as part of a restructuring transaction. Moreover, administration has unfortunate historical associations. We began this report with a brief reference to the contractual era of UK restructuring. In this period, most debt finance was provided to large and small companies in the UK by banks. At the larger end of the market, banks were incentivised to support financially distressed companies by institutionalised norms of behaviour. At the smaller end, a reputation for client care was important and banks were incentivised to support their clients and retain their public reputation where possible.[10] This meant that administration was reserved for situations in which restructuring efforts had failed or, worse, the banks had lost confidence in management. This reputation for administration as a procedure that is used where restructuring attempts have run out of road, or where management is perceived to be at fault for the failure, has largely stuck. The resulting negative connotations of administration for the prospects of a successful rescue, and thus the fear for the reaction of suppliers, customers and employees to news of administration, coupled with the loss of management control, mean that it is very rarely used to provide moratorium protection for a wider restructuring effort.[11] This narrative may be reinforced by the fact that since 2020 English law has offered a different, free standing moratorium in Part A1 of the Insolvency Act 1986. This moratorium suffers from several serious deficiencies,[12] and at the time of writing it has rarely been used. It is, however, explicitly designed to provide a breathing space to stabilise a business and create liquidity while a rescue of the company is attempted. Thus, both practitioners and the courts may expect it to be

9 *Dearing v Skelton* [2020] EWHC 1370 (Ch).

10 Daniel Prentice, 'Bargaining in the Shadow of the Enterprise Act 2002' (2004) 5 European Business Organization Law Review 153, 157 citing D Spahos, *Bank Liability on the Withdrawal of Credit and the Exercise of Default Remedies* (University of Oxford, DPhil, 2002).

11 For a more detailed account, see Rodrigo Olivares-Caminal, Randall Guynn, Alan W Kornberg, Eric McLaughlin, Sarah Paterson and Dalvinder Singh, *Debt Restructuring* (3rd ed. 2022), paras. 3.262-3.267.

12 Sarah Paterson, 'Restructuring Moratoriums through an Information-processing Lens' (2023) 23(1) Journal of Corporate Law Studies 37.

used for this purpose rather than administration. And the Part A1 moratorium does not engage England's transaction avoidance regime.

The second way in which administration may be relevant is to implement a functional cross-class cramdown through an insolvency sale. There are two broad ways in which this can be done. First, at the larger end of the market, the finance holding company for a group with a complex leveraged capital structure is placed into insolvency and its asset (the shares in the parent operating company) is sold by the administrator on, or shortly after, their appointment to a new company owned by the creditors who are staying with the business after the restructuring is completed. Security granted by operating companies over their assets in favour of those creditors who are being left behind is released using contractual mechanisms provided for in an intercreditor agreement that was entered into between the parties when the financial structure was originally put in place. The result is that those creditors who are staying with the firm hold equity in the new finance holding company, and other creditors are left stranded in the now assetless shell. Second, at the smaller end of the market a similar but distinctive process is followed. In this case, the new company is owned by the shareholder(s)/director(s) of the old company, and/or some of its financial creditors, and the new company bids for the business and assets of the old company leaving behind any liabilities that it does not wish to assume.[13]

In both cases, the administration sale delivers something functionally similar to a restructuring – some creditors stay with the business after the sale and have a chance to increase their recoveries, while others are cut out. And if a restructuring is implemented functionally using administration, then England's transaction avoidance provisions will be engaged. However, as we have seen, the administrator will transfer the assets on, or shortly after, appointment. This makes it relatively unlikely that the administrator would consider transaction avoidance claims subsequently.

The other procedure in which the full gamut of transaction avoidance claims would become relevant is liquidation. Liquidation is designed as a break-up procedure in English law: there is no duty on the office holder (the liquidator) to consider rescue; liquidators are only entitled to carry on the business of the company as may be necessary for its beneficial winding up; there are complications in retaining employees; and at best there is only a limited moratorium. This means that it is very unlikely a company would go into liquidation as part of a restructuring strategy. The one exception to this is where government mobilises liquidation in public interest cases that it is heavily involved in

13 For more detail on this technique, see Sarah Paterson, 'Debt Restructuring and Notions of Fairness' (2017) 80(4) *Modern Law Review* 600, 601-602.

and engaged with. This is, however, a rather specific application and need not detain us any further for the purposes of this paper.[14] For our purposes, we will assume that a company seeking to restructure would not use the liquidation procedure.

Building on our brief analysis in this section, our working assumption will be that a company seeking to restructure in England and Wales would not access the administration or liquidation procedure, other than where administration is used proactively to transfer assets to a new company owned by those staying with the firm after the restructuring is completed. Our working assumption is, therefore, that transaction avoidance provisions will not be engaged. We have seen that section 423 claims can be brought outside insolvency and by a victim of the transaction rather than an office holder.[15] Section 423 is a wide-ranging provision. Indeed, the high-profile Sequana case has established that it can extend to the payment of a dividend.[16] However, in order for a claim to be successful it is necessary to establish that the person entering into the transaction did so for the purposes of either putting assets beyond the reach of a person who is making or may at some time make a claim against him or of otherwise prejudicing the interests of such a person in relation to a claim which he is making or may make.[17] It is not necessary for this to be the sole or dominant purpose of the person entering into the transaction – it is enough if it 'can properly be described as a purpose and not merely a consequence, rather than something which was indeed positively intended'.[18] Nonetheless, it can be difficult to establish the relevant subjective intention as a matter of fact. Thus, although section 423 is undoubtedly a useful weapon in the aggrieved creditor's armoury, it is certainly not a panacea.

1.3 Implications for Restructuring

We have seen that most restructurings proceed without administration or liquidation so that, with the exception of section 423 claims, the transaction avoidance regime is not engaged. This has not gone unnoticed and has led to two specific judicial responses. At the same time, as we will see, there are limits on how far the court is willing to go.

14 Readers who are interested in this application are directed to Andrew Keay and Peter Walton, 'British Steel: Is It a Wind Up?' (2019) 12(4) Corporate Rescue and Insolvency 125.

15 (n 8).

16 BTI 2014 LLC v Sequana S.A. [2019] EWCA Civ 112 (appealed to the Supreme Court but not on this point).

17 Insolvency Act 1986, s. 423(3).

18 *IRC v Hashmi* [2002] EWCA Civ 981, [2002] BCC 943, at [23].

1.3.1 Disclosure

The first step that the UK courts have taken is to require disclosure, in the restructuring proposals, of transactions that could be vulnerable to challenge if an administration or liquidation were to be pursued. As we have seen, England has three restructuring procedures: the CVA, the scheme of arrangement and the Part 26A restructuring plan procedure. In all three cases, creditors and shareholders eligible to vote will be sent some sort of explanatory statement, setting out the company's financial position and the proposed solution to it. Precisely because the transaction avoidance regime is only available in administration or liquidation, the court will require that transactions that could be vulnerable to challenge are disclosed. We have seen that all the provisions (other than section 423) mandate a strict time limit, and there is a significant risk that if the restructuring is unsuccessful creditors will find that the relevant time limit has been exceeded and that potential claims have been lost. Thus, as the court said in the Regis case, 'creditors are entitled to know whether there are any potential causes of action which would be lost to them' upon approval of the relevant restructuring proposal.[19]

The first issue with this approach is whether a thorough investigation of the potential claims is likely to emerge. It is notable that Regis proposed a CVA. The CVA is an insolvency procedure found in Part I of the UK Insolvency Act 1986 and provides a mechanism by which a company can restructure its debts. The proposal is made by the company's directors,[20] but the whole process is overseen by a nominee who is a licensed insolvency practitioner.[21] We can expect a licensed insolvency practitioner to take seriously the prospect of transaction avoidance claims that may be lost if the CVA is pursued, and the need to disclose them. No insolvency practitioner is appointed, however, in either the scheme of arrangement or the Part 26A restructuring plan. At the same time, unless the issue is expressly raised, it is unlikely that the court will inquire into potential actions for past faults at the hearings on a scheme of arrangement or Part 26A restructuring plan. In the recent, important Court of Appeal judgment in Thames Water, Sir Julian Flaux, Zacaroli LJ and Sir Nicholas Patten noted various observations by the judge at first instance concerning the financial difficulties of the group. This included unchallenged evidence that the group had paid significant dividends to distribute equity to investors or to service debt.[22] They noted that, while the first instance judge had expressed 'concern at the lack of introspection before the Court about the reasons why the Group has got itself into the current situation', he had also commented that it is 'not for the Court on an application to sanction the Plan to

19 *Carraway Guildford (Nominee A) Ltd v Regis UK Limited* [2021] EWHC 1294 (Ch), at [77].
20 Insolvency Act 1986, s. 1(1).
21 Ibid., s. 388-389.
22 *Kingston S.À.R.L. v Thames Water Utilities Holdings Ltd* [2025] EWCA Civ 475, at [15] (Thames Water).

attribute blame for this'.[23] Instead, the court's focus was 'forward-looking'. The Court of Appeal agreed. The hearing was not about 'past failings' but concerned only with whether the first instance judge had been right to sanction the Part 26A plan.[24]

It is also notable that none of the English restructuring procedures expressly requires the judge to consider the viability of the plan. This issue also arose in Thames Water, where a claim was made that the proposed restructuring was not in the public interest (meaning the interests of the customers of the water company and the wider public's interest in the reliable supply of water and minimising the effluxion of sewerage into rivers and seas) and that an alternative insolvency procedure would be preferable. A specific claim was that, in considering whether the plan before the court was too expensive, the court should pay regard to what the plan would achieve if sanctioned by the court. In restructuring cases, the English court has regularly been at pains to note that it will not act where to do so will be in vain. However, as the Court of Appeal noted in Thames Water, the concern has typically been explored where some condition is required to be fulfilled for the restructuring to take effect that is outside the control of the company.[25] While the Court of Appeal did accept that the prospects of success of the plan may be a relevant factor in the exercise of discretion, 'the Court does not need to be satisfied, to any particular standard' that the plan will succeed.[26] This means that there is a great deal of weight being placed on the fact of disclosure and the ability of creditors and shareholders to balance the benefits of the restructuring against the claims that may be lost. It is, thus, important that the company is asked to confirm that it has disclosed any potential causes of action that may be lost if the restructuring is sanctioned by the court.

The value of any disclosure will also depend on the sophistication of the creditors and shareholders who read it. Subject to a point that we will return to in a moment, sophisticated creditors may be quite willing to forego the opportunities to use transaction avoidance in favour of a restructuring attempt. A bigger issue arises if creditors are less sophisticated and not well-positioned to understand the trade-off that they are making. Amigo, a scheme of arrangement case, is instructive. The Amigo scheme involved redress claims for the mis-selling of financial products to consumers. The relevant regulator, the Financial Conduct Authority (FCA), intervened in the case notwithstanding that the company had achieved the relevant statutory majority in voting on the scheme for the court to have jurisdiction to sanction it.[27] The FCA

23 Ibid., at [16].
24 Ibid.
25 Ibid., at [219].
26 Ibid., at [220].
27 In re All Scheme Ltd [2021] EWHC 1401 (Ch).

considered the scheme inherently unfair and presumably felt that consumer creditors were unable to assess that unfairness. We will return to schemes of arrangement at the end of this section, but the short point that we can draw from Amigo is that the question is not just whether a disclosure is made but also whether the disclosure provides creditors and shareholders with what they need to balance the risks and rewards of the restructuring. One way of tackling this is for the court to pay attention to the quality of the disclosure. Another way of tackling the issue that seems to be gaining traction is to appoint a customer or independent advocate who can represent the interests of unsophisticated consumer creditors before the court.[28] The advocate can, of course, push for disclosure of potential claims and ensure that creditors understand what trade-off they are making if a restructuring is pursued and the claims are lost.

1.3.2 Transaction Avoidance Claims and the Relevant Alternative

A second issue that has arisen in the context of Part 26A restructuring plans is the question of whether a dissenting class would have made a recovery in the relevant alternative. Part 26A of the Companies Act 2006 enables a company to seek court sanction for a plan to restructure its liabilities. Two court hearings are held. At the first, known as the leave to convene or convening hearing, the company explains how it has divided its creditors and shareholders into classes to vote on the plan and asks the court to order the meetings to be held.[29] The company must also satisfy the court that it has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern,[30] and that the purpose of the plan is to eliminate, reduce or prevent, or mitigate the effect of those financial difficulties.[31] The restructuring plan and the explanatory statement are then circulated to creditors inviting them to the meeting to vote.[32] Provided either 75% by value of creditors and/or shareholders present and voting in each class approve the plan,[33] or the conditions of section 901G of the Insolvency Act 1986 are met,[34] the court may sanction the plan at the second hearing. Section 901G provides that the court may sanction the plan over the objections of a class or classes in which the 75% statutory majority in support has not been met, provided no dissenting creditor is worse off under the plan than they would be in the relevant alternative (where the relevant alternative is whatever the court considers would be most likely to occur if the plan were not sanctioned)[35] and at least one class that would receive a payment or have a 'genuine economic interest in

28 Thames Water (n 22), at [222].
29 Companies Act 2006, s. 901C(1).
30 Ibid., s. 901A(2).
31 Ibid., s. 901(3)(b).
32 Ibid., s. 901D.
33 Ibid., s. 901F(1).
34 Ibid., s. 901F(2).
35 Ibid., s. 901G(3) and (4).

the company' in the event of the relevant alternative has voted in favour.[36] The judge then retains a wide discretion to decide whether to sanction the plan or not, even if these statutory conditions are met.[37]

It will be immediately apparent that the court only has jurisdiction to sanction the plan if it is content that the dissenting class is no worse off than it would be in the event of the relevant alternative. Thus, the court must start by identifying what the relevant alternative is and how each class would fare in it. A particularly difficult issue is deciding how the contours of this analysis are drawn, and a specific question is how the court should approach claims that the dissenting class would make a recovery in the relevant alternative through transaction avoidance claims. This issue arose explicitly in Amicus Finance Plc (in administration) (Amicus).[38] This was a rare case in which the plan company was in administration and the administrators proposed the restructuring plan to restructure the company's debt with a view to rescuing it as a going concern. One ground on which the plan was contested was that, in the relevant alternative, the dissenting class would benefit from what was described as a 'clawback claim' in respect of a previous transaction.[39] Norris J noted that the precise nature of this claim was never clearly articulated, but he proceeded to consider potential transaction avoidance claims. In doing so, however, he made several observations.

First, the important point for the purposes of his assessment was the potential net recovery and that the net recoveries would be paid to the estate generally, so that not all recoveries would filter back to the dissenting creditor. Secondly, the relevant transaction avoidance recoveries were available only for unsecured creditors and not the holder of a floating charge. Finally, and crucially, he could not, within a sanction hearing, 'conduct a mini-trial of "clawback" claims without disclosure or evidence' so that

> the sole purpose of examining [the claims] is to see whether on their face they raise such a challenge as to prevent the propounder of the scheme from demonstrating that [the dissenting creditor] is probably better off under the scheme.[40]

Norris J noted that each of the avoidance claims would require investigation, resulting in both expense and delay and prosecution. This compared 'unfavourably with the

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36 Ibid., s. 901G(5).
37 Sarah Paterson, 'Judicial Discretion in Part 26A Restructuring Plan Procedures' https://ssrn.com/abstract=4016519.
38 Amicus Finance Plc (in administration) [2021] EWHC 3036 (Ch).
39 Ibid., at [63].
40 Ibid., at [70].

timing of payments under the proposed plan'. He was also unconvinced as to the relief that could be granted to enhance the assets available for distribution.[41] It was not possible to examine the claims in detail at the sanction hearing, and he did not consider that he could sensibly value them. However, as we have already seen, Amicus was a rare case in which the plan was proposed by an administrator, so that an administrator would be expected to consider whether to bring the claims or not, and claims could be brought against the administrator for breach of duty if they had failed to do so. This meant that, in the administration context, the dissenting creditor preserved the ability to pursue the administrator if there were claims that would have yielded a return, so that they were no worse off under the plan.[42]

The issue arose again in the Great Annual Savings case (GAS).[43] This was the more usual case in which the company was not in administration, so that the analysis of preserving claims against the administrator was not available. In GAS, the company argued that the alternative to the restructuring plan was a non-going concern sale in administration. HM Revenue and Customs (HMRC), the UK tax authority, argued that in this event it would be able to bring a variety of claims, including transaction avoidance claims, to swell its recoveries.[44] Johnson J determined, while recognising that the exercise could not be an 'entirely precise one' because the relevant alternative is only hypothetical, that the evidence before him had too many limitations to justify a conclusion that HMRC would be worse off under the plan than in the event of the relevant alternative.[45] This meant that strictly speaking he did not need to tackle the question of recoveries under potential claims. Specifically, he stated:

> there are real difficulties in seeking to evaluate potential claims in contexts such as the present. A number of obvious limitations apply (eg the Court has had no disclosure). More generally, a sanction hearing is certainly not the appropriate venue for determining the merits of such claims and the Court should not seek to conduct any sort of mini-trial.[46]

Insofar as the claims that fall within the scope of this paper were concerned, Johnson J saw specific difficulties, so that the exercise of attributing any value to the potential claims was 'extremely difficult'.[47] HMRC had, itself, expressed its prospects of success

41 Ibid.
42 Ibid., at [71].
43 In the matter of Great Annual Savings Co Ltd [2023] EWHC 1141 (Ch).
44 Ibid., at [56].
45 Ibid., at [72].
46 Ibid., at [74].
47 Ibid., at [76].

differently for different claims (from 'strong prima facie claims' to 'potential claims'). Counsel for HMRC encouraged the court to reason by assessing the chance of a successful outcome (drawing on the approach that English courts take to the loss of a chance in the law of negligence). This point was, however, raised late, and Johnson J had reservations as to whether it was appropriate in the Part 26A restructuring plan context because, 'assessing the value of a lost chance can itself be a complex and time-consuming exercise involving many variables' so that 'in a contested hearing the exercise could quite quickly develop into a form of mini-trial.'[48] The upshot of all of this was that Johnson J decided he could not 'reliably attribute any present value to the alleged claims'.[49] While he could see that there 'may be proper grounds for thinking they are viable and that there may be a proper basis for bringing them' that was 'a different thing'.[50] As a result, Johnson J left out of account any value that may flow from the claims in arriving at his conclusion that HMRC was no worse off under the plan than it would be in the event of the relevant alternative.

A couple of interim conclusions can be drawn from this brief review. Where the company proposing the restructuring is in administration, the dissenting creditor may be expected to rely on claims against the administrator for failing to pursue transaction avoidance claims rather than propose the plan. These are not easy claims to bring. Nonetheless, this is also not the situation with which we are primarily concerned in this paper because an independent office holder has been appointed who should be expected to weigh up the benefits of pursuing the transaction avoidance claims versus waiving them in the plan. A more difficult question arises where the company is not in administration and a dissenting creditor claims that they are worse off under the plan than they would be in the event of the relevant alternative because they are losing the right to bring transaction avoidance claims. In this scenario, it is suggested here that Norris J adopted the right approach and that the question for the court is whether, on their face, the potential claims raise such a challenge as to prevent the plan company from demonstrating that the dissenting creditor is better off under the plan. It is suggested that this does not require the court to conduct of a mini-trial or to put any firm monetary value on the claim but rather to balance the apparent prospects for the dissenting creditors in pursuing transaction avoidance claims and pursuit of the plan.

1.3.3 Discretion

We should also remember that even if the judge feels unable to arrive at the conclusion that the relevant dissenting creditor is worse off under the plan because of the loss of

48 Ibid., at [77].
49 Ibid., at [78].
50 Ibid., at [78].

transaction avoidance claims, it is still possible they may decline sanction by virtue of the extensive legislatively mandated discretion. The relevant provision states that if the statutory conditions are met the court 'may' sanction the plan,[51] and the Explanatory Notes to the legislation make clear just how wide the discretion is intended to be:

> the court will always have absolute discretion over whether to sanction a restructuring plan. For example, even if the conditions of cross-class cram down are met, the court may refuse to sanction a restructuring plan on the basis it is not just and equitable.[52]

Thus, a judge who takes a broad approach to the loss of transaction avoidance claims and who cannot be satisfied that the 'no-worse-off' test has been met may nonetheless decide as a matter of discretion that the transaction avoidance claims ought to be pursued and that the plan, which risks loss of those claims, ought not to be sanctioned.

1.3.4 Schemes of Arrangement and CVAs

Before moving on, we should touch on the application of the analysis in this part to schemes of arrangement and CVAs. The only jurisdictional hurdle for a scheme of arrangement is that the scheme is approved by 75% by value and a majority in number of creditors and/or shareholders present and voting in each class. However, as with a Part 26A restructuring plan, the court is left with a broad discretion in deciding whether to exercise jurisdiction to sanction the scheme. Nineteenth-century judges developed a decision-making framework within which this discretion is to be exercised that has proved remarkably resilient. The modern formulation was set out by Snowden J (as he then was) in *Noble Group Limited*:

(i) At the first stage, the Court must consider whether the provisions of the statute have been complied with….

(ii) At the second stage, the Court must consider whether the class was fairly represented by the meeting, and whether the majority were coercing the minority in order to promote interests adverse to the class whom they purported to represent.

(iii) At the third stage, the Court must consider whether the scheme is a fair scheme which a creditor could reasonably approve. Importantly, it must be appreciated that the Court is not concerned to decide whether the scheme is the only fair scheme or even the "best" scheme.

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51 Insolvency Act 1986, s. 901F.

52 Explanatory Notes to the Corporate Insolvency and Governance Act 2020, para. 15 repeated in similar terms in para. 190 'Drawing on well-established principles in schemes of arrangement, the court has absolute discretion over whether to refuse to sanction a plan even though the necessary procedural requirements have been met. This may be, for example, because a plan is not just and equitable.'

(iv) At the fourth stage, the Court must consider whether there is any “blot” or defect in the scheme that would, for example, make it unlawful or in any other way inoperable.[53]

The court will start from the proposition that creditors are better judges of what is in their interests than the court.[54] Thus, the starting point will be that, as the majority vote in support has been achieved in every class, the scheme is a fair one. However, the court is alert to concerns that the majority vote is not representative of fairness of the scheme, for example, because the majority was motivated by some other, extraneous consideration than the fairness of the plan for the relevant class, or (as we saw in our discussion of the Amigo scheme) because sufficient disclosure was not made for the class to know what it was about in exercising its vote. The court will, therefore, cross-check the fairness of the plan, usually by reference to how the parties would have fared in the fallback option without the scheme (typically referred to as the counterfactual in this context). Thus, there is room for a dissenting minority to raise objections based on the claim that they would be better off pursuing transaction avoidance claims that will or may be lost if the scheme is sanctioned.

We have already seen that CVAs are somewhat different from both restructuring plans and schemes of arrangement because an insolvency office holder is appointed. Indeed, we suggested in this context that there is an easier hook on which to hang demands for real investigation of transaction avoidance claims that might be lost if the restructuring is pursued. A further important difference is that no court hearing is held to approve a CVA unless a creditor or member launches a challenge to the plan. One ground on which a challenge can be raised is that the CVA unfairly prejudices the interests of a creditor or member of the company.[55] A court will typically approach a challenge of this type, among other things, by comparing the returns to the creditor or member in the CVA and their returns if it had not been approved. A creditor or member could, therefore, launch a challenge on the basis that valuable transaction avoidance claims are or may be lost in the CVA and that that unfairly prejudices their interests.

There are, however, cost issues that arise in this context. In the scheme of arrangement and Part 26A restructuring plan context, the English courts have adopted a relatively nuanced approach to costs where a challenge fails, given that the company is seeking the approval of the court and not a remedy or relief against another party. This means that the general rule of civil procedure for litigation in England (the loser pays) does

53 Re *Noble Group Limited* [2018] EWHC 3092 (Ch), at [17].
54 Re English, Scottish, and Australian Chartered Bank [1893] 3 Ch 385.
55 Insolvency Act 1986, s. 6.

not apply. In deciding the appropriate costs order to be made, the courts are mindful of not deterring members or creditors from raising genuine issues, and that ordering the company to pay objecting creditors' costs may 'enable matters of proper concern to be fully ventilated before the court, thereby assisting the court in its scrutiny of the proposals'.[56] The court is unlikely to make an adverse costs order against objecting members of creditors in the scheme or Part 26A context unless it considers the objections 'frivolous' and may even make an order for the company to pay the costs if the objections have assisted the court.[57] The upshot is that in most cases a creditor or member who raises an objection on the basis that valuable transaction avoidance claims will be lost is unlikely to face an adverse costs order, even if they are unsuccessful, unless the court considers the claim to be frivolous – and may even stand a chance of recovering its costs from the company.

The courts have, in contrast, treated an objection to a CVA as 'normal' litigation. This is most thoroughly addressed by Norris J in Debenhams, and it is worth setting out his comments in full:

> In a CVA dissentient creditors are bound by the outcome of the statutory meetings (not by any order of the Court). They can seek a Court order overturning or varying that outcome within a limited time and only on the grounds specified in s.6 of the Insolvency Act 1986. That requires an application with respondents; and the need to establish one of the specified grounds creates a classic "*lis*". There will in the end be a "successful party" and an "unsuccessful party" and the "general rule" is capable of application (though of course with the proviso that in all the circumstances a different order might be made). If the dissentient creditors' challenge is successful, then the company may be expected to be viewed as the "unsuccessful party" and under "the general rule" to face the prospect of paying the dissentient creditors' costs. If the dissentient creditors' challenge is unsuccessful, then they may expect to be viewed as the "unsuccessful party" under "the general rule" and to face the prospect of paying the company's costs.[58]

Thus, the creditor or member who objects that a CVA is unfairly prejudicial because valuable transaction avoidance claims will be lost takes a significant risk on costs if they are unsuccessful. And we have already seen how difficult it is for a judge to refuse sanction of a restructuring on the basis of such claims. This means that in the CVA

56 Re *Virgin Active Holdings Ltd* [2021] EWHC 911 (Ch), at [29].
57 Ibid.
58 *Discovery (Northampton) Ltd v Debenhams Retail Ltd* [2020] EWHC 1430 (Ch), at [13].

context a creditor or member may need to rely on their practical ability to press the insolvency practitioner to explore potential claims and the risks for the insolvency practitioner if they do not do so. It is worth noting that insolvency practitioners are licensed professionals in the UK and that it is possible for a dissatisfied creditor to lodge a complaint with the regulator.[59] While at present this does not result in compensation for the creditor, the regulator can impose a range of disciplinary measures that are damaging for the insolvency practitioner. The last government suggested that it would develop proposals for a redress and compensation scheme for those adversely impacted by insolvency practitioners,[60] and the current government may yet take this forward. In any event, creditors may be able to use the threat of a report to the regulator to incentivise an insolvency practitioner to take the potential for transaction avoidance claims more seriously, as an alternative to taking the risk of a costs order in a complaint to court against either the company or the office holder.

2 Directors' Duties

2.1 Directors' Duties and Transaction Avoidance

Thus far we have referred, with broad strokes, to England's transaction avoidance regime. The careful reader will already have noticed that the regime is somewhat weak when compared with the equivalent regime in many other jurisdictions. Notably, both preferences and transactions at an undervalue have significant subjective elements that can make a successful claim very difficult indeed. We have seen that in order for a transaction to be vulnerable as a preference, the company must have been influenced in deciding to give the preference by a desire to produce the preferential effect. It is not sufficient to establish a desire to produce the preferential effect – as Millet J (as he then was) said in his oft-quoted judgment in MC Bacon, 'A man is not to be taken as *desiring* all the necessary consequences of his actions.'[61] Instead, it is necessary to show that the company was 'influenced' by the desire in taking the decision to enter into the transaction.

This approach is adopted in part because English law has historically rewarded the diligent creditor who takes action to protect their position. If the company pays a creditor not because they wish to put them in a better position than they would otherwise be

59 https://www.gov.uk/complain-about-insolvency-practitioner.
60 *The Future of Insolvency Regulation: Government Response*, 12 September 2023, www.gov.uk/government/consultations/the-future-of-insolvency-regulation/outcome/the-future-of-insolvency-regulation-government-response# (accessed 13 May 2025).
61 In *re MC Bacon Ltd* [1990] BCC 78, 87.

in a liquidation, but because unless they pay the creditor will refuse further supply, or will increase prices, or will take some other action, then the company will not have been influenced by the desire to prefer and the payment will not be vulnerable, at least unless the parties are connected.[62] The overall effect is to make it very difficult to challenge a preference in English law other than to a connected person, where there is a rebuttable presumption of the desire to prefer.[63] Similarly, the defence to a transaction at an undervalue claim also has subjective elements.

England does, however, offer another potential avenue of attack for payments to creditors in the lead-up to insolvency proceedings. When the directors know or ought to know that the company is insolvent or bordering on insolvency or that an insolvent liquidation or administration is probable, in carrying out their duties to the company they must have regard to creditor interests.[64] Thus, the director must have regard to the interests of creditors in fulfilling the duty in section 172(2) of the Companies Act 2006 to act in a way he considers, in good faith, would be most likely to promote the success of the company. Kristin van Zwieten has compellingly shown that this creditor-regarding duty has frequently been exploited as an alternative to bringing a preference action,[65] a conclusion with which Andrew Keay has agreed.[66] A claim can be brought by a liquidator or administrator or, where the company is in the course of winding up, by a creditor using the procedure set out in section 212 of the Insolvency Act 1986.

A claim for breach of directors' duties is not a straightforward alternative to a transaction avoidance claim. Difficult questions arise as to whether it is possible to bring the claim where the transaction is similar to a transaction avoidance claim but does not meet all of the statutory requirements for a claim, notably in the context with which we are concerned where the time period for a transaction avoidance claim has passed but the claim is still within the limitation period for a directors' duties action. Difficult questions arise, too, where a claim is brought against the director, but the company has suffered no loss because the effect of the payment is simply to favour one creditor over another.

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62 Ian F. Fletcher, 'Voidable Transactions in Bankruptcy: British Perspectives' in Jacob S. Ziegel and Susan I. Cantlie, *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994).

63 Insolvency Act 1986, s. 239(6).

64 *BTI 2014 LLC v Sequana* [2022] UKSC 25.

65 Kristin van Zwieten, 'Director Liability in Insolvency and Its Vicinity' (2018) 38(2) *Oxford Journal of Legal Studies* 382.

66 Andrew Keay, 'Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interests' (2020) 136 *Law Quarterly Review* 52.

The Supreme Court in Stanford International thought that company loss may be problematic where the payment complained of was preference-like but did not meet the statutory requirements for an unlawful preference.[67] We return to this point where time lapses as a result of a restructuring, but a valid claim would have been available if the company had gone into insolvency proceedings, below, and note here that it may also be possible to frame the claim in the context of one of the director's other duties, such as the duty to act within powers.[68] And while a directors' duties claim may be preferable to a transaction avoidance claim if the recipient of the original payment is themselves insolvent or unable to pay, it may be less appropriate where the purpose of the claim is to claw money back from a recipient who remains credit worthy. Both van Zwieten and Keay explore other actions that may be available against recipients in the event of a director's duties claim, such as dishonest assistance and knowing receipt, but both causes of action pose challenges. In *GHLM v Maroo*, Newey J explored whether the company can avoid the contract on normal agency principles, but this is also likely to be challenging in the normal run of things.[69] We should also note that, provided the directors have turned their minds to the interests of creditors, the duty is to act in what the directors, and not what the court, consider to be in the best interests of the company, having regard to the interests of the creditors. The question for the court is whether the directors honestly believed that their act or omission was in the interests of the company, having regard to the creditors. In other words, the issue is a director's state of mind, so that it will be difficult to challenge properly recorded conclusions. It is not impossible to raise a challenge – in *HLC Environmental Projects* it was said,

> No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest.[70]

Undoubtedly, however, a challenge is not straightforward.

Overall, a director's duties claim may not be a perfect substitute for a transaction avoidance claim that is lost as a result of a restructuring transaction. Nonetheless, it is clear that no account of the relationship between restructuring and claims for past behaviour is complete without considering the effect of restructuring on claims against directors. That is where we turn next.

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67 *Stanford International Bank Ltd (in liquidation) v HSBC Bank plc* [2022] UKSC 34, at [72]-[75].
68 Companies Act 2006, s. 171.
69 *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), at [162]-[180].
70 *HLC Environmental Projects* [2013] EWHC 2876 (Ch), at [91] citing Jonathan Parker J. (as he then was) in Re *Regentcrest plc v Cohen* [2001] 2 BCLC 80, at [120].

2.1.1 Directors' Duties and Disclosure

We have already touched on the fact that, outside a CVA and assuming the company is not placed into administration and does not seek to take advantage of the Part A1 moratorium, no insolvency practitioner is appointed who would have a duty to investigate whether there are vulnerable transactions that are being lost as a result of a restructuring transaction. And we have already noted that courts should perhaps require plan companies to investigate this issue and discharge an obligation to the court to show that they have done so. Framing the inquiry in the directors' duties context puts this issue in sharper relief because it highlights just how little incentive directors have to lift the lid on potentially dubious past transactions in seeking the sanction of the court. It is difficult to imagine a board voluntarily undertaking a review of potential breaches of duty and disclosing them.

2.1.2 Releases

Even more crucially, putting the transaction avoidance question in the directors' duties frame highlights the importance of focusing on any releases that are granted to directors as part of the restructuring transaction. It is possible to release claims against third parties in English CVAs, schemes of arrangement and Part 26A restructuring plans. Releases are most readily approved where the released claims cover the same loss that is being compromised in the plan, and the third party would have an enforceable claim against the company pursuant to a right of indemnity – a so-called ricochet claim.[71] However, schemes and Part 26A restructuring plans have also frequently contained releases for directors, officers and others. In English law, the company has only limited ability to indemnify the directors,[72] and the position of advisers will depend on their engagement letter, so that claims of this type will not necessarily create a ricochet claim, or at least not for the full amount of the claim. Nonetheless, in several cases this has not been a bar to sanction.

In New Look, Zacaroli J noted that if there had been breaches of duty in promoting the scheme, this may create a 'blot' on the scheme, so that it should not be sanctioned. Where no such argument had been raised, he considered that the relevant persons should have certainty that no such claim can subsequently be sought.[73] The text of the releases is not set out in the judgment, but it appears that they related to promotion of the scheme. This also appears to be the position in Far East Capital, in which we are told that creditors would agree not to bring any claims against the relevant parties in connection with the preparation, negotiation or implementation of the scheme.[74] In

71 Re *ColourOz Investment* 2 LLC [2020] EWHC 1864 (Ch), at [72].
72 Companies Act 2006, s. 232.
73 Re *New Look Financing plc* [2020] EWHC 3613 (Ch), at [27].
74 In the matter of *Far East Capital Limited SA* [2017] EWHC 2878 (Ch) [13]-[14].

Noble, the releases appear wider, extending to 'the Scheme Claims and any of the facts and matters giving rise to the Scheme Claims'.[75] It is not entirely clear what this would catch, but Snowden J (as he then was) interpreted it as claims that would undermine the compromise between the company and the creditors if pursued.[76]

The real question, for the purpose of this paper, is the position if the company tries to push the envelope more aggressively, including a much broader range of historic claims within the scope of the release. In *Noble*, Snowden J described the basis of releasing claims against directors, officers and others as requiring scheme creditors 'to release claims against third parties where such a release is necessary in order to give effect to the arrangement between the company and the scheme creditors'.[77] Snowden J noted that the jurisdiction to release third parties is most clearly satisfied where there is a ricochet claim but said that it included releases necessary so that scheme creditors could not 'undermine the terms of the scheme itself'.[78] This was subject to detailed review in Thames Water.[79] The Court of Appeal agreed that the risk of ricochet claims is not the only justification for the release of third parties and stated that

> The overriding consideration is that releases against third parties are permitted where "necessary in order to give effect to the arrangement proposed for the disposition of debts and liabilities of the company to its own creditors".[80]

Thames Water included a relatively broadly drafted release, in which many individual parties, including the creditors and the relevant companies:

> waives, releases and forever discharges any and all actions, proceedings, claims, damages, counterclaims, complaints, liabilities, liens, rights, demands and set-offs, whether present or future, prospective or contingent, whether in this jurisdiction or any other or under any law, of whatsoever nature and howsoever arising, whether in law or in equity, in contract (including, but not limited to, breaches or non-performances of contract), in statute or in tort (including, but not limited to, negligence and misrepresentation) or in any other manner whatsoever, breaches of statutory duty, for contribution, or for interest and/or costs and/or disbursements, whether or not for a

75 *Noble* (n 53), at [22].
76 Ibid., at [24].
77 Ibid.
78 Ibid., at [25].
79 (n 22).
80 Ibid., at [240] citing Re *Lehman Bros (No. 2)* [2009] EWCA Civ 1161, [2009][sic] Bus L R 489, per Patten LJ, at [65].

> fixed or unliquidated amount, whether filed or unfiled, whether asserted or unasserted, whether or not presently known to the parties or to the law, in each case that it ever had, may have or hereafter can, shall or may have arising out of actions, omissions or circumstances on or prior to the Transaction Effective Date against each and any Released Party whatsoever or howsoever arising (and notwithstanding any subsequent facts or information becoming known following the Transaction Effective Date), in relation to or arising directly or indirectly out of or in connection with, the negotiation, preparation, sanction or implementation of the Plan and/or the Interim Platform Transaction (including, without limitation, the negotiation, preparation, sanction or implementation of any Transaction Documents).[81]

We should note that although the release is broadly drafted, it still relates only to issues arising in the conduct and implementation of the Plan. Nonetheless, the Court of Appeal was

> not satisfied that a release of potential assets in any future insolvency proceedings of the Plan Company … consisting of their own possible claims against directors and advisers, is justified as being necessary to enable the Plan to be implemented.[82]

It noted in particular that the fact that no breaches of duty had been identified or put to the directors in cross-examination to answer during the case did not alter this assessment. It recognised that those opposing the plan did not have access to information that would be available to a future office holder if the company were to go into insolvency proceedings and, echoing the concerns for a mini-trial that we met in the context of transaction avoidance provisions themselves, noted that

> neither the Court nor the parties to a restructuring procedure can be expected to divert time and resources to investigating the possibility of such claims in the course of seeking the sanction of a proposed plan.[83]

Crucially, creditor releases were acceptable because, if they were not included, creditors whose claims against the company had been released might bring claims against the directors or other third parties and that might result in ricochet claims against the company. This could clearly not arise when it was the company itself that was pursuing

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81 Ibid., at [225].
82 Ibid., at [241].
83 Ibid., at [242].

the claims.[84] It must be said that this does fit entirely comfortably with the finding that the risk of ricochet claims is not the only justification for the release of third parties, as it is the risk or otherwise of ricochet claims that appears to distinguish the approach to releases by creditors and releases by the company. And there is no discussion in the judgment of the extent of a ricochet claim, given the limitations on indemnification discussed above.

Counsel for the company in Thames Water raised the further objection that the companies could grant the releases in any event. The Court of Appeal considered that that might be true where the plan returned the company to solvency but did not apply in the circumstances of Thames Water, which related to an interim plan so that the company would remain insolvent following its implementation. In these circumstances, it was 'far from clear' that the relevant companies could grant effective releases.[85] Of course, this leaves open the risk that the point is relitigated in cases where the plan returns the company to solvency (a more common scenario). This is reinforced by the fact that the Court of Appeal ordered a carve out for claims that might subsequently be brought by an insolvency office holder where they considered that if a full restructuring were to be successfully implemented, 'the possibility that there may have been claims against directors or advisers in relation to the preparation and implementation of the Plan becomes for practical purposes irrelevant.'[86]

Thames Water does, however, provide a blueprint for the circumstances in which dissenting creditors raise serious concerns about the feasibility of the restructuring plan and argue that they would be better off pursuing claims against the directors. In this case, the court may be understandably wary of refusal to sanction even if it accepts that there is a good chance that the plan may fail. In these circumstances, carving claims that an insolvency office holder may bring out of the release may provide a way forward. We have seen that there is a question mark over how substitutable directors' duties claims are for transaction avoidance claims. Where, however, the court has consciously left open claims at sanction of a restructuring plan, and it subsequently transpires that valid claims would have been available if the company had entered insolvency proceedings instead, it may be prepared to admit claims against directors even where there is a question mark over loss to the company.

84 Ibid., at [239].
85 Ibid., at [243].
86 Ibid., at [245].

3 Company Directors Disqualification Act

Before wrapping up our discussion we ought to note, for completeness, the Company Directors Disqualification Act 1986 (CDDA). The CDDA entitles the Insolvency Service (an executive agency of the Department for Business and Trade), acting on behalf of the Secretary of State for Business and Trade, to seek to disqualify a person from acting as a director. Since 2000 it has been possible for agreement to be reached with the director outside court, and since 2015 it has been possible for the Secretary of State to seek compensation from the directors. While a full review of the regime clearly falls outside the scope of this paper, it is worth noting that the regime may, in appropriate cases, play some role in incentivising directors to take seriously future consequences of using restructuring strategically to avoid transaction avoidance claims. It may also offer another avenue of redress where it transpires that claims were not adequately disclosed at the time of the restructuring or that appropriate steps were not taken to ensure that creditors were able to understand the trade-off they were making between pursuing transaction avoidance claims and supporting a restructuring effort.

4 Conclusion

English restructuring law is essentially forward-looking – as the Court of Appeal put the point in Thames Water in determining whether to approve a restructuring the English court is not concerned with past failings. Nonetheless, the English courts are mindful that the consequence of approving a restructuring may be that potentially valuable rights to challenge past transactions are lost. This concern manifests itself in two ways. First, the court will expect any potential claims to be disclosed in the proposal to creditors. Secondly, the court may entertain claims from creditors that they are worse off as a result of the plan because they are losing valuable transaction avoidance claims or that the court ought not to exercise its discretion to sanction a plan because the creditors ought to be free to pursue transaction avoidance claims instead. We have seen that the prospects of claims being disclosed may be better where an insolvency practitioner is engaged, although we have also seen that in the CVA context this is balanced against the cost risks associated with launching a claim. We have noted that the Company Directors Disqualification regime may play some role in incentivising directors not to propose a restructuring as a purely strategic effort to swerve a transaction avoidance claim. We have also seen that the directors' duties regime may provide another avenue of attack and that the English courts are showing themselves mindful of this in reviewing releases that are required in plan documents. If the court is looking determinedly ahead then it must ensure that it preserves the ability for others to look back if things do not turn out well.

Along the way, we have made several suggestions. First, as already noted, we suspect that whether there is disclosure of potential avoidance claims or not may vary, depending on whether an independent office holder has been appointed or not. We have therefore suggested that the court should positively ask the company for evidence that it has considered whether there are any potentially valuable claims that will be lost and that it has disclosed them. We have also seen that particular attention may be needed where creditors are less sophisticated, so that they clearly understand the potential claims that are at stake and can decide whether they wish to trade the potential for recovery against the possibility of a rescue of the firm. The concern here should be both to ensure straightforward disclosure and to require the appointment of an independent advocate who can understand the trade-off that is at stake and can present it to the court.

Nonetheless, the court must remain realistic about the prospects of full disclosure. Where a creditor runs the argument that they are worse off under the plan than they would be in the event of the relevant alternative, the court can only realistically draw broad conclusions on whether there is enough to the claim to support the creditor's desire to pursue it in place of a restructuring. The court may also decide, as a matter of discretion, that even if it cannot be satisfied on the no-worse-off test, the transaction avoidance claims are sufficiently serious to suggest that sanction should not be granted. This is likely, however, to be rare and reserved only for egregious cases. Overall, then, the court must do what it can to preserve the ability for others to look back if it turns out that moving forwards was not, after all, the right thing to do, particularly where the court and the creditors did not have all the facts at the time that decisions were made.

In this context, given the risk that relevant time periods for transaction avoidance claims may lapse as a result of the restructuring, courts should do what they can to preserve the directors' duties as an alternative remedy, ensuring that releases are not so widely drafted that such claims are lost. Ex post, where it becomes clear that relevant claims were not adequately disclosed at the time of the restructuring or that creditors did not appreciate the trade-off they were making, the court should take a broad view of the ability to bring claims against the directors where relevant time limits for transaction avoidance claims have been exceeded. Creditors should, of course, take advice on the full range of options available to them. There may be cases in which it is appropriate for the State to mobilise the powers in the Company Directors Disqualification Act to compensate creditors when neither the transaction avoidance regime nor the directors' duties regime can do so. While English courts have been vigilant about the risks of judging with hindsight, there are cases where hindsight is a wonderful thing.

From Avoidance to Value: Pre-Filing Irregularities Under the WHOA

Krijn Hoogenboezem[*]

1. Introduction

1.1. This paper addresses the question how to deal with 'irregularities' that took place prior to the commencement of a proceeding under the Wet Homologatie Onderhands Akkoord (**WHOA**).

1.2. This paper addresses the situation that in the course of the WHOA proceeding, one or more creditors come to suspect that irregularities took place before the WHOA proceeding was commenced (i.e. pre-filing)[1] and what actions they may take.

1.3. As will be set out in this paper, the issue of irregularities should be dealt with primarily in the analysis of the value of the plan and the provision of information to stakeholders.

1.4. Part A of this article contains some thoughts about the role of irregularities in determining the value of a WHOA plan. The analysis will deal with most well-known examples of claims arising out of pre-filing irregularities, that is, directors' liability (Chapter 5) and three specific grounds for transaction avoidance, being transactions at undervalue (Chapter 6), preference (Chapter 7) and avoidance of obligatory legal acts (Chapter 8).

1.5. Part B of this paper deals with information about irregularities. Chapter 9 addresses the issue of collecting information regarding pre-filing irregularities. Chapter 10 specifically addresses related-party transactions and the suggestions to create an explicit obligation of the debtor to provide stakeholders with

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1 The actual 'filing date' of a WHOA proceeding is not fixed, is dependent on the specific facts of the case and may be quite late in the process. What is meant with 'pre-filing' is that the irregularities took place before the WHOA plan is confirmed and are separate from the WHOA proceedings.

information about related-party transactions. Chapter 11, finally, provides some ideas regarding potential actions that may be considered by stakeholders if pre-filing irregularities only come to light after the confirmation decision. This involves potential directors' liability claims for sharing misleading information.

1.6. This is also a good place to stress there is thus far only limited literature and very little other guidance about how participants in a WHOA proceeding are to address concerns about pre-filing irregularities. In that sense, much of this paper is speculative. One could argue, for example, that a plan should never be confirmed in cases involving pre-filing irregularities.[2] The idea would be that only debtors in good faith and with clean hands could make use of the WHOA proceedings. This line of reasoning has the merit of being clear and having a deterrent effect. However, one can easily think of cases where all stakeholders, including creditors that have been prejudiced by pre-filing irregularities, are better off if a plan is confirmed. Therefore, this paper aims to create awareness and to provide some suggestions as to how a plan may be pursued and confirmed be while safeguarding claims arising out of irregularities.

1.7. Below I will refer to the court deciding in a WHOA proceeding as simply the **Court**, leaving out the specific district court that formally renders the decision.[3] The creditors and shareholders involved in a WHOA proceeding will be referred to jointly as the **stakeholders**.

1.8. Unlawful acts by the debtor prior to commencement of a WHOA proceeding will be referenced as **pre-filing irregularities**. Behaviour that may give rise to claims based on transaction avoidance is referenced to as a **detrimental act**.

1.9. This paper will not deal with the infamous Peeters/Gatzen claim.[4]

1.10. The archetypical case in conceptualizing the working of a WHOA plan is a going-concern scenario in which the debtor as a legal entity continues to exist and

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2 See M.J. Verstijlen, e.a., *Evaluatie Wet homologatie onderhands akkoord*, 18 December 2023, WODC rapport 3387, p. 114: 'A large majority of respondents (88%) is of the opinion that indications of irregularities are definitely a ground for refusal of confirmation,' see also M.-H.S. Berghuijs & C.M. Harmsen, 'Misbruik', *De WHOA van wet naar recht*, para. 14.2.8., J.A. van der Meer e.a., 'Misbruik van de WHOA In het licht van een jaar rechtspraak', *HERO* 2022 / P-020, para. 3.

3 The panel in a specific WHOA case is made up of judges from different district courts anyway, the so-called WHOA pool. As a result, there is little added value in naming the specific district court responsible for the decision in the case.

4 A claim to be brought in liquidation proceedings by the trustee for the benefit of the joint creditors because of unlawful prejudice caused to the joint creditors by a third party.

operate. Under the WHOA, it is also possible to sell the business, much like a US 363-sale, and liquidate the company. Also in such cases, the value created by such plan will be referred to, as is common, as the reorganization value – although of course the debtor will not continue trading.

Part A – Irregularities and Valuation

2. Preparatory Works

Restructuring Directive

2.1. The Restructuring Directive[5] (**RD**) was implemented in the Netherlands through the WHOA. In its recitals, the Restructuring Directive summarily deals with the topic of potential pre-filing irregularities.

2.2. First of all, recital 27 RD allows Member States to limit access to a restructuring framework of (i) debtors that have been sentenced for serious breaches of accounting or book-keeping obligations (see Art. 4(2) RD) and of (ii) debtors whose books and records are incomplete or deficient to a degree that makes it impossible to ascertain the business and financial situation of the debtor.

> In one of the first WHOA decisions, the Court refused to extend a cooling-off period on the basis, among others, that the financial position of the debtor, as reviewed by the court-appointed observer, was insufficiently clear.[6]

2.3. Secondly, in relation to avoidance actions specifically for new or interim financing, recital 67 RD provides that the directive is without prejudice to other grounds for declaring new or interim financing void or voidable. This recital deals only with the provision of new and interim financing and will not be further discussed here, since the focus here is on pre-filing irregularities.

5 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

6 Rb. Amsterdam 23 maart 2021, *JOR* 2021/218.

2.4. It is noteworthy that the Restructuring Directive deals with detrimental acts (such as transactions at undervalue and preference) specifically through the lens of 'management decisions'. Recital 71 RD provides the following (emphasis added):

> Where the debtor is close to insolvency, it is also important to protect the legitimate interests of creditors from <u>management decisions</u> that may have an impact on the constitution of the debtor's estate, in particular where those decisions could have the effect of further diminishing the value of the estate available for restructuring efforts or for distribution to creditors. It is therefore necessary to ensure that, in such circumstances, directors avoid any deliberate or grossly negligent actions that result in personal gain at the expense of stakeholders, and <u>avoid agreeing to transactions at below market value</u>, or taking actions leading to <u>unfair preference</u> being given to one or more stakeholders.

The Directive does not make explicit how irregularities are to be addressed.

2.5. Detrimental acts may give rise to several legal actions. A detrimental act may lead to a transaction avoidance action as well as a directors' liability claim. The Restructuring Directive focuses on the behaviour of management rather than avoidance actions and, as will be discussed below in Chapters 6 and 7, perhaps for good reasons.

<u>WHOA legislation and preparatory works</u>

2.6. While the Dutch legislator has attached great importance to the identification and suppression of pre-fling irregularities in a bankruptcy procedure by a court-appointed bankruptcy trustee, it is noticeable that the statutory provisions of the WHOA do not address pre-filing irregularities at all. Also in the legislative history of the WHOA, the topic has received little attention. Parliament did approve a specific motion on the subject of pre-filing irregularities. The motion provides the following:

> requests the government to promote that plans will not be confirmed in the case of detrimental acts, fraud, recidivism and factual or legal abuse of power by (indirect) shareholders, other related parties and/or external financiers….[7]

7 Motie Van der Graaf en Van Nispen, *Kamerstukken II* 2019/2020, 35249, nr. 17.

2.7. On the basis of this motion, it is suggested that the Courts should deny confirmation of a plan in case detrimental acts are found to have taken place,[8] or even if any irregularities took place.[9] I disagree with these suggestions. As will be detailed further below, there are cases in which it is worthwhile and beneficial to stakeholders that a plan is confirmed notwithstanding detrimental acts by the debtor, simply because the liquidation value of the debtor (including the value of the avoidance actions and directors' liability claims) is much lower than the reorganization value. That, of course, does not mean that the irregularities should be ignored. To the contrary, I will argue in this article that in many cases where pre-filing irregularities occurred and where addressing these would represent value in the reorganization scenario, such claims should be pursued. Therefore, a general prohibition of confirmation of any plans regarding companies where pre-filing irregularities occurred, should not apply.

3. Irregularities Under Dutch Law

Introduction

3.1. This chapter provides a short and high-level introduction to the most relevant Dutch statutory provisions regarding irregularities, both inside and outside bankruptcy.

3.2. Before providing a high-level description of the most important elements of directors liability and transaction avoidance in the Netherlands, it seems helpful to state here already that in dealing with detrimental acts in a WHOA procedure, there is one principal difference between directors' liability claims on the one hand and avoidance actions on the other. That is, the debtor itself does not have transaction avoidance actions at its disposal. Such actions only pertain to prejudiced creditors or, in the case of a bankruptcy, to the bankruptcy trustee on their behalf. As to directors' liability, the analysis is more complex, with certain types of liability constituting a claim by the debtor itself and others being a claim held by creditors or a bankruptcy trustee.

8 Berghuijs & Harmsen, a.w., Van der Meer & Helmons, a.w. More nuanced are W.J.B. Van Nielen e.a., 'Onderzoek naar en recuperatie van onregelmatigheden onder de WHOA', *FIP* 2021/1, p. 17 e.v.

9 Verstijlen e.a., a.w., p. 114: 'A large majority of respondents (88%) is of the opinion that indications of irregularities are definitately a ground for refusal of confirmation.'

Directors' liability

3.3. To be very succinct and leaving aside any causes of action arising out of specific legislation such as tax laws, the three main grounds for directors' liability are (i) liability towards to company (Art. 2:9 DCC), (ii) liability in bankruptcy proceedings for the entire deficit (Art. 2:248 DCC) and (iii) liability towards the company or to third parties on the basis of tort (Art. 6:162 DCC).

3.4. Tort claims of the company against its own directors will not be addressed separately here. The treatment of company tort claims is very similar to the treatment of Article 2:9 DCC claims. Tort claims of third parties against directors remain in place following the confirmation of a WHOA plan, unless a third-party release is granted. Whether or not third-party releases of directors for tort claims can be part of a WHOA plan and whether or not such releases can be confirmed are complex issues that will not be addressed in this article.[10] Reference is made to the abundant literature on this point.[11] This article will therefore focus on Articles 2:9 and 2:248 DCC claims.

3.5. Article 2:9 DCC relates to the liability of a director towards the company. It provides that each director is obligated in relation to the company as a legal entity to properly fulfil their duties. In this regard, each director bears responsibility for the general course of affairs. Should the management duties be inadequately performed, liability of a director arises only if they can be seriously blamed ('*ernstig verwijt*') for the conduct in question. Under Article 2:9 DCC, the central question is whether the director has acted as may be expected of a director who is competent for its role and performs its duties with due care and diligence. Whether there is a case of serious blame must be assessed based on the specific circumstances of the case.[12] Acts that violate statutory rules intended to protect the legal entity will, in principle, result in liability.[13]

3.6. Article 2:248(1) DCC only applies in bankruptcy. A director of a private limited liability company may be held personally liable by the bankruptcy trustee for the entire deficit in the bankruptcy estate if there has been manifestly improper management and it is plausible that this improper management was an important cause of the bankruptcy. Manifestly improper management can only be established

10 Rb. Amsterdam 21 juni 2023, *JOR* 2023/224 (*Steinhoff*), ECLI:NL:RBAMS:2023:4152.

11 See a.o. A. Tavakolnia, 'Het einde van nonconsensual non-debtor releases in Chapter 11. De mogelijke implicaties van Purdue Pharma voor de WHOA', *TvI* 2024/21.

12 HR 10 januari 1997, ECLI:NL:HR:1997:ZC2243 (*Staleman/Van de Ven*).

13 HR 29 november 2002, ECLI:NL:HR:2002:AE7011 (*Berghuizer Papierfabriek*).

if no reasonably thinking director would have acted in the same manner under the given circumstances. Legislative history indicates that the improper conduct must be beyond doubt.

3.7. The behaviour addressed and the norms provided by Articles 2:9 and 2:248 DCC tend to converge.[14] Many directors' acts that are contrary to the test contained in Article 2:248 DCC will also be contrary to the test in Article 2:9 DCC. This paper does not purport to detail the subtle differences between these provisions and the legal tests derived therefrom (the discussions often boil down to a close reading of court cases and are virtually impossible to translate), and I will simply refer to the behaviour addressed as 'mismanagement'.

3.8. This is not to say that Articles 2:9 and 2:248 DCC are identical. There are a number of important differences between Articles 2:9 and 2:248 DCC which are set out in paragraph 5.2 below, including the consequences of these differences for a WHOA proceeding.

Transaction avoidance

3.9. Transaction avoidance plays an important role in the sphere of bankruptcy proceedings. The bankruptcy provisions are at first glance relatively easy, with a basic distinction between the avoidance of voluntary legal acts under Article 42 DBA and obligatory legal acts under Article 47 DBA. This Article 47 DBA is discussed in a bit more detail in Chapter 8.

3.10. Articles 42 and 47 DBA only apply once a bankruptcy proceeding has been opened. Outside a bankruptcy, creditors can rely on the transaction avoidance action set out in Article 3:45 DCC.[15] This provision, like Article 42 DBA, only

14 W.A. Westbroek, *Bestuurdersaansprakelijkheid in theorie* (Instituut voor Ondernemingsrecht nr. 108), para. 3.7.5. Zie ook Concl. A-G Timmerman 20 september 2018, ECLI:NL:PHR:2018:1139 (*Geocopter*) en, voor een nuancering van de overeenkomsten, M.C. Leijten e.a., 'Kroniek bestuurdersaansprakelijkheid', *Geschriften vanwege de Vereniging Corporate Litigation 2022*-2023, para. I.1.3.3.

15 This chapter contains a description of the out of bankruptcy transaction avoidance action based on 3:45 DCC. It is however not a given that Dutch law will apply. The international private law rules are inconclusive regarding out of bankruptcy avoidance actions. There are convincing arguments that the law applicable to out of bankruptcy avoidance actions is (should be) the law that applies to the legal act that it intends to avoid (Asser/Kramer & Verhagen, 10-III 2022/397:397 Gewone pauliana). This certainly has the benefit that all avoidance actions against that legal act are governed by the same law. Note that would mean that English law governed financing documentation cannot be voided by an Art. 3:45 DCC action. However, the applicability of the law governing the legal act to be avoided is by no means certain. Neither EU rules on applicable law, nor Book 10 DCC contains a rule in which this is specifically determined and Dutch literature is divided on this issue.

applies to voluntary legal acts. Case law as to the distinction between voluntary and obligatory acts applies to both. The conditions for transaction avoidance under Article 3:45 DCC and Article 42 DBA are very similar, with the exception of the relative nature of transaction avoidance outside bankruptcy.

3.11. In case of a WHOA, there is no bankruptcy and also no trustee that has been appointed. Creditors can therefore invoke the transaction avoidance action set out in Article 3:45 DCC. Although this has not (really)[16] been brought before the Court yet, such avoidance action can also be instituted during WHOA proceedings.

3.12. In case of a juridical act not by gratuitous title, a detrimental voluntary legal act can be avoided on the basis of Article 3:45 DCC if, at the time of performance of the legal act, the debtor and the counterparty knew or should have known that the legal act would cause detriment to the possibility of recourse of (one or more of) the debtor's creditors. Similar conditions apply in bankruptcy.

3.13. When assessing whether a legal act caused detrimental effect, all adverse and favourable consequences of the legal act, direct and indirect, must be considered.[17] If a transaction consists of an interconnected set of legal acts, the bankruptcy trustee (in bankruptcy) or a creditor (outside bankruptcy) cannot only avoid the allegedly detrimental legal acts while disregarding acts that may have benefitted creditors. In case of interconnectedness, only the combination of legal acts taken as a whole can successfully be avoided.[18]

3.14. If it has been established that a legal act caused detriment, a legal act that is not by gratuitous title can only be avoided if the bankruptcy trustee or, outside bankruptcy, a creditor states and proves that both the debtor and its counterparty, at the time of the challenged legal act, knew or ought to have known that it would cause detriment.[19] Whether such knowledge did exist must be assessed

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16 Art. 3:45 DCC was mentioned in Rechtbank Amsterdam 24 oktober 2022, *JOR* 2023/159, m.nt. Lok, ECLI:NL:RBAMS:2022:8286 but in such a flawed case that this decision is of little help. In Rechtbank Dan Haag 3 september 2021, ECLI:NL:RBDHA:2021:9782, a creditor alleged that avoidable transactions took place but did not invoke Art. 3:45 DCC and the Court did not address this point (confirmation was denied on other grounds).

17 To successfully invoke an avoidance action on the basis of Art. 42 DBA or Art. 3:45 DCC, the facts must demonstrate that the challenged legal act has caused actual detriment to the possibility of recourse of the creditor seeking the avoidance of the legal act. A mere possibility or even likelihood of detriment occurring is insufficient.

18 HR 19 december 2008, *JOR* 2009/172 m.nt. D.J. Bos, ECLI:NL:HR:2008:BG1117.

19 Art. 42(2) DBA, Art. 3:45(2) DCC.

on the basis of the facts at the moment the legal act was performed. Though a creditor has the burden to substantiate knowledge, certain conditions may trigger presumptions of knowledge that will alleviate the creditor's burden.

3.15. An avoidable juridical act is nullified either by an extrajudicial declaration or by a court's judgment.[20] The bankruptcy trustee or, outside bankruptcy, a creditor can therefore avoid a transaction by simply sending a letter to that effect to the debtor and its counterparty.[21]

Presumptions

3.16. For gratuitous legal acts performed by the debtor within one year prior to the challenge, there is a separate rebuttable presumption that the debtor knew or ought to have known that the legal act would cause detriment (Arts. 45 DBA and 3:47 DCC).

3.17. In case of a juridical act not by gratuitous title where the avoidance action is invoked within one year of the legal act that has been established to have caused detriment, Article 43 DBA in bankruptcy and Article 3:46 DCC outside bankruptcy provide certain rebuttable presumptions in relation to the requirement that both the debtor and its counterparty knew or ought to have known that the legal act would cause detriment. Knowledge of the detrimental effect is, among others, presumed in the event of (i) a 'transaction at undervalue', (ii) payment of an undue debt, (iii) providing security for an undue debt or (iv) a transaction with a related party.

3.18. The legal presumptions for transaction avoidance outside bankruptcy (Art. 3:46 DCC) are identical to the legal presumptions for transaction avoidance inside bankruptcy (Art. 43 DBA). I will deal with these one-year presumptions for related-party transactions in more detail below in Chapter 10.

Relativity

3.19. Article 3:45(4) DCC provides that a creditor who avoids a legal act that was detrimental does this for their own benefit only and that the avoidance has no further effect than is required to address the detriment imposed on them.[22] This

20 Art. 3:49 DCC.
21 Art. 3:50(1) DCC.
22 GS Vermogensrecht, Art. 3:45 BW, aant. 9.4: Relatieve nietigheid.

means, for example, that if the creditor who avoided the action receives a payment compensating them for this detriment, they no longer have any interest pursuing the avoidance.[23]

3.20. The relativity of an avoidance based on Article 3:45 DCC also means that if one creditor avoids a legal act, other creditors do not benefit.[24]

3.21. In relation to any other than the specific creditor(s) who avoided the action, the action remains valid. This is a crucial effect of the relativity of the Article 3:45 DCC action which does not apply (in the same way) in bankruptcy in relation to an Article 42 DBA action. The following example from case law serves to illustrate the consequences of the relativity of the non-bankruptcy avoidance action:[25]

> The son sells a house to his father. A creditor of the son avoids the sale (and transfer) on the basis of Article 3:45 DCC. Following this, the son has mortgaged the house to his father.
> The Amsterdam Court of Appeals held that the avoidance of the sale by the creditor was relative and therefore could only be relied upon by that creditor. The creditor could therefore seize the house. However, in the relationship between the son and the father, the sale was not void and the father was therefore the owner. The son was not competent to mortgage the house.

3.22. It is specifically the relativity of the Article 3:45 DCC action that renders it quite complex to address pre-filing detrimental acts within a WHOA proceeding, as will be set out in later chapters.

4. Relevant WHOA Confirmation Requirements

4.1. Before discussing the role that irregularities play in the analysis of a proposed plan and its confirmation by the Court, it may be helpful to briefly describe a few important elements of the role of value in WHOA proceedings.

23 Hof Arnhem 10 december 1991, *NJ* 1993/40.

24 Asser/Sieburgh 6-III Algemeen Vermogensrecht, 2022/599 Relatieve en beperkte werking vernietiging.

25 Hof Amsterdam 23 augustus 2016, ECLI:NL:GHAMS:2016:3419.

4.2. The creation and distribution of additional value for the stakeholders is central to preventive restructuring frameworks such as the WHOA.[26] The rescue of struggling businesses is not a goal in and of itself; the rescue is a consequence of the assessment that in a specific case, and the rescue plan delivers more value to the stakeholders.[27] The Restructuring Directive states among others the following:[28]

> Those [restructuring] frameworks should … maximise the total value to creditors – in comparison to what they would receive in the event of the liquidation of the enterprise's assets or in the event of the next-best-alternative scenario in the absence of a plan – as well as to owners….

4.3. In sum, the WHOA plan should preserve value that the debtor has,[29] provide additional value in comparison with a bankruptcy and distribute the value of the debtor in an acceptable fashion among the stakeholders.

4.4. If not all classes have accepted the plan, the Court can use its cross-class cramdown powers. Under the WHOA, the debtor can petition for Court approval of the plan if at least one class of creditors has voted in favour of the plan. If the plan amends the rights of 'in the money' creditors, the class of creditors that voted in favour of the plan must consist of such in the money creditors.[30] The Court will as soon as possible determine a date for a confirmation hearing.[31] This date will be between eight to fourteen days after the voting report was submitted with the Court. If there is a dissenting class and a restructuring expert or an observer has not been appointed yet, the Court will appoint an observer in that same decision.

4.5. Until the day of the hearing, creditors or shareholders can submit a petition to deny confirmation of the plan. The Court will decide on the confirmation request as soon as possible.[32] Article 384 DBA contains the grounds on which the Court can deny confirmation of the plan. The grounds can be divided into general grounds for rejection to be applied *ex officio* and additional grounds for rejection to be invoked by a stakeholder.

26 A.M. Mennens, *Het dwangakkoord buiten surseance en faillissement* (Onderneming en recht nr. 118), para. 4.3.
27 Vgl. Mennens, para. 120.
28 Recital 2 RD.
29 *Kamerstukken II* 2018/19, 35249, nr. 3, p. 50.
30 Art. 383 (1) DBA.
31 Art. 383 (4) DBA.
32 Art. 384 (1) DBA.

General grounds for rejection

4.6. The general grounds for rejection include the debtor not being in the state of pre-insolvency, the debtor not having provided the prescribed information to the creditors and shareholders, a creditor not having been allowed to vote for the correct amount and the performance of the plan not being sufficiently safeguarded. The general grounds for rejection are imperative. If the Court deems a general ground for rejection to exist, the Court must refuse confirmation, regardless of whether or not a creditor or other stakeholder has made such request.

4.7. Three of the general grounds for rejection seem particularly relevant in the event that pre-filing irregularities took place at the debtor:

a. Irregularities are relevant in the determination of the liquidation value,[33] and in many cases also the reorganization value, and where relevant should be disclosed when a WHOA plan is proposed (see para. 5.24 and further below).[34,35,36] Arguably, therefore, if material irregularities took place and these were not properly disclosed to stakeholders, the Court should, as a rule, refuse confirmation of the proposed plan if these irregularities come to light at the confirmation hearing or any other occasion before confirmation.[37] This would serve as a strong incentive for the debtor to 'come clean' as, following a rejection of the plan, the debtor cannot commence WHOA proceedings for a period of three years unless the plan is proposed by a restructuring expert.[38]
b. The Court will deny confirmation of the plan if performance of the plan is not sufficiently guaranteed.[39] The performance of a plan may well be deemed not sufficiently guaranteed if the collection of certain claims is not certain. The Court has decided a case in which some of the funds required for the

33 Rb. Amsterdam, 28 februari 2022, *JOR* 2022/189, m.nt. K.P. Hoogenboezem, ECLI:NL:RBAMS:2022:886. The same applies to a release of such liabilities: Rb. Amsterdam 21 juni 2023, *JOR* 2023/224 (*Steinhoff*), ECLI:NL:RBAMS:2023:4152.
34 Art. 384(2)(c) in conjunction with Art. 375(1)(f) and (e) DBA.
35 S.W. Van den Berg & M.R. Schreurs, artikel 375 Fw, aantekening 1.4; N. Elferink, 'De WHOA, misbruik en de rol van de observator', *HERO*, 2022 / P-017, para. 3.
36 In A. Karapetian, 'Bestuurdersaansprakelijkheid onder de WHOA', in *De WHOA van wet naar recht*, chapter 17, p. 312, it is argued that Art. 375 DBA does not apply to directors' liability issues because Art. 375 DBA pertains to information relevant for the plan itself, and not to information regarding the factual course of events pre-filing. I do not agree with this analysis. The factual course of events and the ensuing value of (potential) directors' liability claims are relevant for the plan itself and therefore must be included.
37 Art. 384(2)(c) DBA. See also the decision in Rb. Amsterdam 5 November 2022, *JOR* 2022/70 (*Worldwide Travel Group*), para. 7.4, where the court holds: 'Furthermore, the observer's investigation has revealed indications that K may offer greater recourse in bankruptcy than is apparent from WWTG's petitions. WWTG has, once again, paid insufficient attention to this aspect in its request.'
38 Art. 369(5) DBA.
39 Art. 384(2)(e).

performance of the plan were to be received as payment on an existing claim (in that case for COVID-19 support funds).[40] The Court found the collection of this claim to be uncertain and held:

> Whether all requirements for payment have been met and, if so, when the payment of these … funds will take place, remains uncertain. The mere fact that advance payments have already been disbursed … does not guarantee that the remaining funds will also be received…. All things considered, the Court is of the opinion that it is not sufficiently certain that the applicant will also have access to the as-yet unpaid portion of the subsidy. Consequently, the fulfilment of the plan is not sufficiently guaranteed.

The Court may therefore take into consideration whether the (potential) claims arising out of irregularities will in fact be investigated and, where appropriate, pursued following confirmation of the plan.

c. The Court will deny confirmation if 'there are other reasons that oppose the restructuring plan.'41 Potentially, this could apply in the event that although the plan preserves value, provides additional value and distributes that value in an acceptable fashion to creditors, the irregularities are so egregious that confirmation is simply not acceptable.42

<u>Additional ground for rejection – best interests of creditors test</u>

4.8. The Court may refuse confirmation on the basis of the additional grounds for rejection if a creditor who voted against the plan requests the Court to do so. An important ground for rejection is the so-called best interest of creditors test, also referred to as the 'no creditor worse off test'. Article 384(3) DBA provides that upon the request of a creditor or shareholder who voted against the plan or who was wrongly excluded from the vote, the Court may refuse confirmation if there is *prima facie* evidence that the relevant creditor or shareholder will be worse off under the plan than they would have been in a liquidation of the debtor's assets in bankruptcy.

40 Rb. Limburg 22 november 2021, ECLI:NL:RBLIM:2021:8857.
41 Art. 384(2)(i) DBA.
42 See van Nielen e.a., a.w., para. 2.

4.9. If any dissenting creditor states it is in fact worse off by the plan, the Court will test such statement by comparing the distributions under the plan with the estimated proceeds such creditor would receive in a liquidation scenario. Under the WHOA, the liquidation scenario is a bankruptcy.[43]

4.10. Any claims that a bankruptcy trustee would have, they must be taken into account in determining the liquidation value and the anticipated distributions to creditors. These claims include any claims arising out of or in connection with any irregularities that took place prior to the bankruptcy.[44] As a result, in the event that irregularities occurred, the liquidation value is increased by the estimated value of these claims when pursued by a bankruptcy trustee.

Additional grounds for rejection

4.11. If confirmation is sought regarding a plan which one or more classes have rejected (i.e. the so-called cross-class cram down) the following grounds for rejection apply:[45]

a. A small- to medium-sized enterprise (SME) creditor being offered less than the prescribed minimal 20% of the nominal value of its claim, while no imperative ground for doing so has been demonstrated.
b. The value realized with the plan (i.e. the reorganization value, or value of the reorganized debtor) is not distributed in accordance with the ranking of stakeholders and this deviation is to the detriment of the creditor who voted against the plan (WHOA priority rule).
c. The creditor who voted against the plan, not being a secured lender, was not offered the possibility to opt for a cash payment in the amount of the liquidation value of their claim (cash-out option).
d. The creditor who voted against the plan is a secured creditor who has granted the debtor financing on a commercial basis and is under the plan offered shares or depositary receipts of shares without the right to opt for a distribution in a different form.

4.12. If one of the classes votes against the plan, a dissenting creditor from this dissenting class may rely, among others, on the WHOA priority rule.[46] Not offering the reorganization value to creditors may be in breach of the WHOA

43 Art. 375(1)(f) DBA.
44 A.o. Rb. Amsterdam, 28 februari 2022, *JOR* 2022/189, m.nt. K.P. Hoogenboezem, ECLI:NL:RBAMS:2022:886.
45 Art. 384(4) DBA.
46 Art. 385(4)(b) DBA.

priority rule, for example, if this means that value is allocated to lower ranking groups of stakeholders, while a higher ranked dissenting class has not been paid in full.[47]

4.13. In a decision of 18 January 2023, the Court held that although the proposed amount in the plan was not based on the reorganization value of the debtor, this did not bar confirmation of the plan,[48] because the amount offered was the maximum amount that would be made available by financiers, the creditors were informed of the deviation from the reorganization value in a timely fashion and only one creditor voted against the proposed plan.[49] The Court further explained that this decision should not be taken as to allow disregarding the reorganization value as the basis for the amounts distributed to creditors (in case only the general grounds for refusal are tested) as that would cripple the absolute priority rule as an important starting point of the WHOA. This decision is essentially the exception that proves the rule that the entire reorganization value must be distributed to stakeholders. The Court will deny confirmation if the debtor proposes a plan in which a value is offered that is lower than the reorganization value and the debtor is not sharing all relevant financial information.[50]

Confirmation and 'overwhelming support'

4.14. By now, it is settled law that the Court will test these confirmation criteria less extensively if there is 'sufficient support' (generally referred to as 'overwhelming support') of the stakeholders for the plan.[51]

5. Value of Directors' Liability Claims

5.1. This chapter provides some suggestions as to how to deal with the value of directors' liability claims in WHOA proceedings.

5.2. As stated above, this paper focuses on the application of Articles 2:9 and 2:248 DCC. There are important differences between an Article 2:9 DCC claim and an

47 S.W. Van den Berg & M.R. Schreurs, Groene Serie Privaatrecht artikel 385 Fw, aantekening 4.3.
48 On the basis of Art. 385(2)(i) DBA.
49 Rb. Midden-Nederland 18 januari 2023, *JOR* 2023/191, m.nt. Harmsen.
50 Rb. Rotterdam 9 juni 2022, ECLI:NL:RBROT:2022:12156, Van den Berg & Schreurs, artikel 384, aantekening 3.9.
51 See a.o. Rb. Amsterdam 21 juni 2023, *JOR* 2023/224 (*Steinhoff*), ECLI:NL:RBAMS:2023:4152, para. 11.1.

Article 2:248 DCC claim that affect the valuation of irregularities in a WHOA plan. Six of the main differences are set out in the below table:

	Difference	**Relevance**
Bankruptcy	An Article 2:248 DCC claim can only exist in bankruptcy. An Article 2:9 DCC claim can exist both in and outside bankruptcy (Art. 2:248(8) DCC).	As a result, an Article 2:248 DCC claim is only relevant in determining the liquidation value, whereas an Article 2:9 DCC claim is relevant for both the liquidation value and the reorganization value.
Nominal value	An Article 2:248 DCC claim in principle leads to liability for the entire deficit in bankruptcy while applicability of Article 2:9 DCC leads to liability for the amount of damages caused to the company by the mismanagement.	This is relevant here because the nominal amount of an Article 2:248 DCC claim in bankruptcy may be significantly higher than an Article 2:9 DCC claim.
Causality	Article 2:248 DCC requires the mismanagement to be an important cause of the bankruptcy, Article 2:9 DCC requires that the damages of the company were caused by the mismanagement.	This is relevant here because there are many cases in which the alleged mismanagement cannot be considered an important cause of the bankruptcy and therefore Article 2:248 DCC does not apply. In those cases, the alleged mismanagement could give rise to an Article 2:9 DCC claim both in the liquidation and the reorganization scenarios.
Legal presumptions	Legal presumptions may apply in the case of Article 2:248 (see para. 5.17 below) and do not apply to Article 2:9 DCC claims.	If the Article 2:248 DCC legal presumptions apply, the debtor should explain in its filings how the legal presumptions are rebutted or, if they cannot be rebutted, what the value of such Article 2:248 DCC claim should be.
Assignment or pledge	An Article 2:9 DCC claim is a claim of the company against its directors that can exist both outside and inside bankruptcy. An Article 2:9 DCC claim can be assigned and pledged. An Article 2:248 DCC claim, by contrast, only comes into existence in a bankruptcy and cannot be assigned or pledged.	This is relevant because an Article 2:9 DCC claim may be part of the bank's collateral whereas an Article 2:248 DCC claim cannot be pledged and is not subject to any pre-filing pledge or assignment deeds.

	Difference	Relevance
Discharge	The company can discharge ('release') its directors for any claims of the company against them. A discharge for an Article 2:248 DCC claim is not possible (Art. 2:248(6) DCC).	If a discharge applies, an Article 2:248 DCC claim is much more attractive.

Value

5.3. Before some illustrations of the treatment of directors' liability claims in WHOA proceedings are presented, this is a good place to stress again that what is central in these analyses is the net value of the various claims. Of course, the fact that a potential Article 2:248 DCC claim is for the entire deficit in the bankruptcy estate is an important part of this analysis, but the anticipated (net) proceeds of directors' liability claims in bankruptcy should not be overestimated.[52]

5.4. The value of a directors' liability claim should be determined by taking into account at least: (i) the nominal value of the claim, (ii) the chances of success in court, (iii) anticipated costs associated with pursuing the claim and (iv) the actual recourse that can be taken on the directors, including any D&O policies.

Worldwide Travel Group

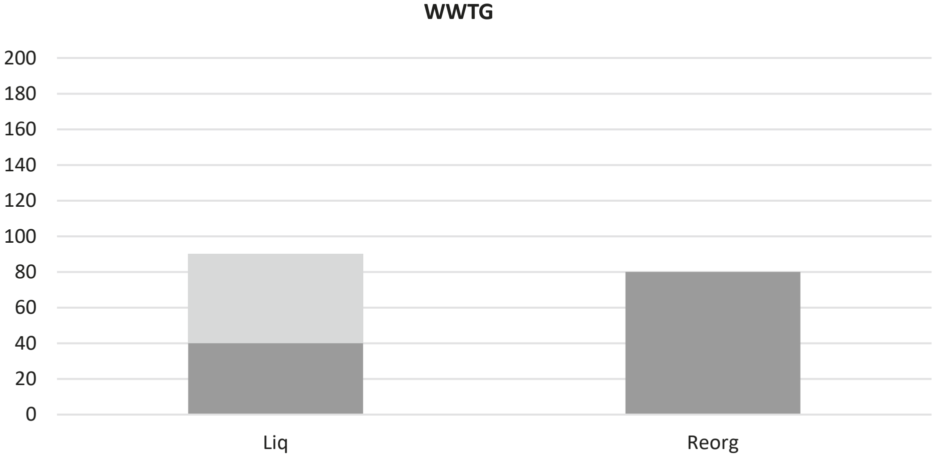
5.5. The role of directors' liability claims can be illustrated well by (a simplified version of) the 2022 decision of the Court regarding *Worldwide Travel Group* (**WWTG**).[53] In short, sometime pre-filing, the director of the debtor had used COVID-19 support funds to invest in options on crypto currencies, which subsequently 'evaporated'. The Court considered that in a bankruptcy, the director may successfully be held liable and that this may lead to additional assets for the bankruptcy estate, given that recourse was (partially) available. The Court held:[54]

> It is established … that a significant cause of the situation in which WWTG currently finds itself is the conduct of its director (**K**). K has used the corona subsidies and loans made available to WWTG by the government and the bank to invest in options on crypto currencies, which has resulted in the dissipation of these funds. It cannot be ruled out that, in the event

52 Vgl. P. Neijt & M. Broekema, 'De Liquidatiewaarde onder de loep', *HERO* 2024 / P-028.
53 Rb. Amsterdam 5 november 2022, *JOR* 2022/70 (*Worldwide Travel Group*).
54 Ibid., para. 7.4.

of WWTG's bankruptcy, a trustee could successfully hold K liable on the grounds of directors' liability. This could result in value, in the form of a claim against K, accruing to the estate, which is currently not included in the WHOA arrangement. Furthermore, the observer's investigation has revealed indications that K may offer greater recourse in bankruptcy than is apparent from WWTG's petitions. WWTG has, once again, paid insufficient attention to this aspect in its request.'

5.6. On the basis of this argument the Court decided not to continue the cooling-off period.[55] In this simplified version of the decision, the Court has effectively done so because there is potentially a large claim on the director of WWTG in bankruptcy, which significantly increases the liquidation value of the debtor, rendering the liquidation value higher than the reorganization value. The following graph illustrates this position. The black column is the value of the claim for irregularities (the figures in the graph are for discussion purposes and to not relate to numbers from the case itself):



Pre-filing Article 2:9 DCC claim

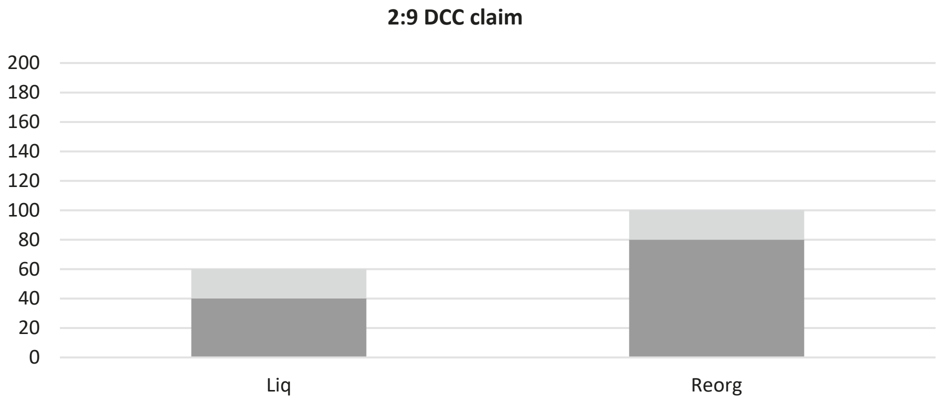
5.7. Is this analysis in this simplified version of the WWTG case fully convincing?

5.8. In order to determine the role of the value if directors' liability claims in WHOA proceedings, let's first turn to an Article 2:9 DCC claim of the debtor company on its director. Such Article 2:9 DCC claim is an *asset* of the debtor. As such, an

55 Art. 376 DBA.

Article 2:9 DCC directors' liability claim is not impacted by the confirmation of a WHOA plan (bar any discharge contained in the plan) and remains the same both before and after confirmation.

5.9. If there are potential Article 2:9 DCC claims that do not give rise to any claims under Article 2:248 DCC in a potential bankruptcy, the determination of the liquidation value and the reorganization value should be fairly straightforward,[56] as is illustrated by the following graph (the black column is again the value of the claim for irregularities):



5.10. Note that the graph above illustrates that the existence of directors' liability claims is relevant in determining the reorganization value and may therefore influence the allocation of value to stakeholders in the WHOA plan.

5.11. Although the debtor remains legally entitled to the Article 2:9 DCC claim post-confirmation, doubts may arise as to whether the debtor will actually pursue the directors' liability claim (see para. 5.32 and further below).

5.12. It cannot be excluded that certain debtors will not provide the required information regarding (material) irregularities and will simply state that no irregularities took place. This will be addressed in part B of this paper.

Large 2:248 DCC claim in liquidation scenario

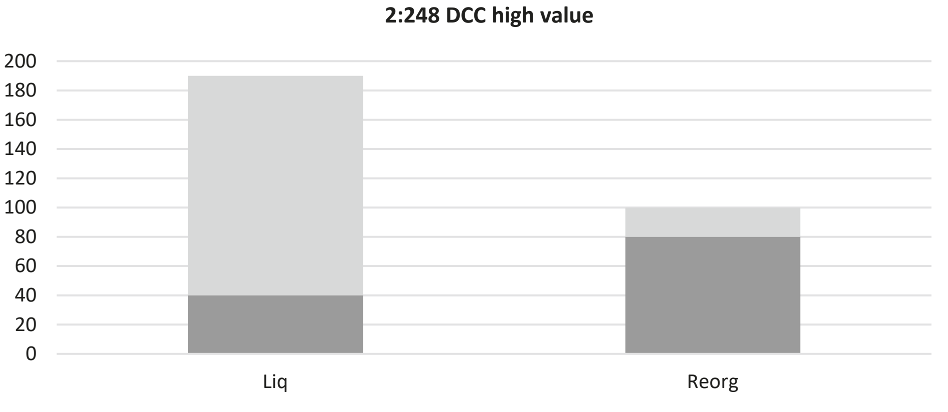
5.13. A claim based on Article 2:248 DCC only arises in the event of a bankruptcy and can only be made by a bankruptcy trustee. If a WHOA plan is confirmed and as

56 See also See van Nielen e.a., a.w., para. 4.

a result bankruptcy is not declared, an Article 2:248 DCC claim will simply not arise. If there are serious indications that a valuable Article 2:248 DCC claim would arise in the bankruptcy of the debtor, this increases the liquidation value of the debtor.

5.14. However, if there are grounds to hold a director liable on the basis of an Article 2:248 DCC claim, there are likely also grounds to hold a director liable on the basis of Article 2:9 DCC (see para. 3.7). Many directors' acts that are contrary to the test contained in Article 2:248 DCC will also be contrary to the test in Article 2:9 DCC. In the case of WWTG, for example, using COVID-19 support funds to invest in options on crypto currencies would likely be considered mismanagement under both Article 2:9 DCC and Article 2:248 DCC.

5.15. If the value of the Article 2:248 DCC claim is high, the liquidation value may well exceed the reorganization value (including an Art. 2:9 DCC claim), as illustrated by the following graph:



5.16. In this example, it is more than likely that some creditors are worse off in the reorganization scenario than they are in the liquidation scenario and therefore any such creditor who voted against the plan can prevent confirmation of the plan on the basis of the best interests of creditors test. If the directors' conduct leading to the liability claim is particularly disturbing – and perhaps there is no 'overwhelming support' for the plan – the Court may also decide to refuse confirmation already on the basis of 384(2)(i) DBA.

5.17. In this context, the presumptions in Article 2:248 DCC are relevant for the information that is to be shared by the debtor. The bankruptcy estate is presumed to have a significant claim on the directors in the event that the bankrupt debtor has not filed its annual accounts in time in the three years leading up to the bankruptcy, or its books and records are not in order. In such case, the company is deemed to be mismanaged, and the mismanagement is presumed to be an important cause of the bankruptcy.[57] This potential Article 2:248 DCC claim must be included in the liquidation value. The debtor should, in my view, either allocate value to an Article 2:248 DCC claim or provide a credible rebuttal of the presumption that mismanagement was an important cause of the bankruptcy by explaining which circumstances, not in themselves constituting mismanagement, did lead to the bankruptcy. The rebuttal of the presumption that mismanagement was an important cause of the bankruptcy is in most cases heavily factual and may well require independent review. A debtor to whom this presumption applies is therefore well-advised to request the Court to appoint an observer early on in the process (see para. 9.17 and further).

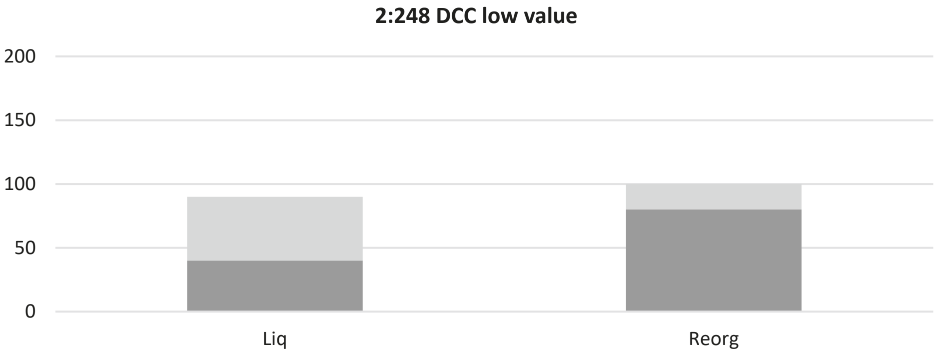
> The District Court of Amsterdam was called upon to decide on the consequences of the late filing of the debtor for the pending WHOA proceeding. A dissenting creditor argued that because of the (presumptive) Article 2:248 DCC claim, the plan failed the best interests of creditors test. The Court summarily decided, on the basis of information the debtor brought forward in the confirmation hearing, that it was sufficiently likely that an alternative cause of the bankruptcy would be accepted (the COVID-19 pandemic) as a result of which the alleged Article 2:248 DCC claim was found to have no value.[58]

<u>Small 2:248 DCC claim in liquidation scenario</u>

5.18. If the value of the Article 2:248 DCC claim in the liquidation scenario is lower, the calculus will change. This can be due to several factors, including means of recourse against a director if a claim would be successful.

5.19. Going back to the simplified version of the WWTG case, it could be that the value of the potential Article 2:248 DCC claim in the liquidation scenario is significant, but not as high as in the previous graph:

57 Art. 2:248(2) DCC.
58 Rb. Amsterdam, 28 februari 2022, *JOR* 2022/189, m.nt. K.P. Hoogenboezem, ECLI:NL:RBAMS:2022:886.



5.20. In the above scenario, the reorganization value (including the Art. 2:9 DCC claim) is higher than the liquidation value (including either an Art. 2:248 DCC or an Art. 2:9 DCC claim). In principle, therefore, the directors' liability issues in and of themselves should not prevent confirmation of the proposed plan.

5.21. This graph illustrates that it is important to realize that if it is argued that the liquidation value is higher because of directors' liability issues (e.g. an Art. 2:248 DCC claim), the reorganization value probably is higher as well because there can be a corresponding Article 2:9 DCC claim. Had the debtor not included the Article 2:9 DCC claim in the reorganization value in this example, the liquidation scenario would have been higher than the reorganization value and the chances of having this plan confirmed significantly lower.

5.22. In the actual decision in WWTG, the Court took a claim for irregularities into account in the liquidation scenario. It was not (explicitly) considered whether a claim for irregularities would also be available in the reorganization scenario. It seems likely the debtor could have argued this.

5.23. In sum, the existence of a potential Article 2:248 DCC claim in the liquidation scenario may, in and of itself, not be a decisive argument to rule against the debtor.

<u>Is the debtor obligated to include the Article 2:9 DCC claim in the reorganization value/ discharge?</u>

5.24. It follows from the previous paragraphs that it may be beneficial for a debtor to include the value of an Article 2:9 claim in the reorganization value as it increases the likelihood that the plan is confirmed. But is the debtor also *obliged* to include the value of a potential Article 2:9 DCC claim? In my view, the debtor is indeed obliged to do so, simply because a (material) Article 2:9 DCC claim is an asset of the debtor that increases the reorganization value of the debtor and that should therefore be included in the reorganization value (either as a 'non-operating asset'[59] or because of an asset-based analysis). The Court has held that it will, in principle, deny confirmation if the debtor proposes a plan in which value is offered that is lower than the full reorganization value.[60]

5.25. One could argue that an Article 2:9 DCC claim that has merit and for which recourse can be taken, nonetheless has no value and need not be included in the reorganization value if the debtor does not intend to pursue the claim post-confirmation.

5.26. This argument seems flawed. If the debtor decides not to pursue the Article 2:9 claim, this amounts to a release of value that the debtor has and effectively a discharge of the director(s). The debtor should include such discharge in the plan presented to the stakeholders. If the stakeholders are properly informed about the potential directors' liability claim and the proposed discharge and the relevant stakeholders nonetheless vote 'overwhelmingly' in favour of the plan, the Court may well decide to confirm the plan. If there is less support for the plan, the decision will depend on the specific facts of the case (see also Chapter 6 regarding transactions at undervalue).[61]

5.27. In light of the above, stakeholders should be critical of any plan that contains a discharge for directors. In that context, inspiration can be drawn from the recent Thames Water decision, where the English Court of Appeals refused to allow a release of directors by the debtor (what we would refer to in the Netherlands as a discharge).[62]

59 Other types of non-operating assets are a.o. investments in other companies, idle land or even patents that are not currently in use.

60 Rb. Rotterdam 9 juni 2022, ECLI:NL:RBROT:2022:12156, rov. 5.6.4, S.W. Van den Berg & M.R. Schreurs, artikel 384, aantekening 3.9.

61 Note that this example does not constitute a third-party release. It does not affect the rights creditors themselves may have against third parties, here possibly the directors.

62 The English Court of Appeals held (emphasis added): '240. We accept that the risk of ricochet claims is not the only justification for the release of third parties. The overriding consideration is that releases against third parties are permitted where "necessary in order to give effect to the arrangement proposed for the disposition of debts and liabilities of the company to its own creditors": see Re Lehman Bros (No2) [2009] EWCA Civ 1161, [2009] Bus LR 489, per Patten LJ at §65. 241. The release of claims by the Plan Company … against [its] own officers and advisers does not in our view, however, satisfy that test. We recognise that the directors of, and advisers to…, the Plan Company are operating in highly difficult circumstances. That is true of directors and advisers in the case of many financially distressed companies. We stress that we have not been provided with any reason to conclude that there has been any breach of duty by the directors, and we recognise that the release in issue relates only to their conduct in relation to the preparation and implementation of the Plan. Nevertheless, we are not satisfied that a release of potential assets in any future

General ground for refusal – performance of the plan not guaranteed

5.28. Having established that there is an Article 2:9 DCC claim in the reorganization scenario, in many cases one can reasonably doubt whether the debtor will actually pursue the directors' liability claim.[63]

5.29. If the doubts as to a proper investigation and pursuit of potential claims are legitimate and are not addressed, the Court may consider that the performance of the plan is not sufficiently guaranteed and deny confirmation on that ground.[64] It must be noted that while, based on the preparatory works to the Act,[65] the performance of the plan concerns only a limited test, this limitation concerns the performance of the commitments to creditors and not the reorganization value itself.[66]

5.30. The Court has held that it will, in principle, deny confirmation if the debtor proposes a plan in which a value is offered that is lower than the reorganization value.[67] Logically, that means that, as a rule, claims for irregularities should be pursued in order to realize the full reorganization value. As stated above (para. 4.7(b)), in one case the Court found the collection of a claim to be too uncertain and held that therefore the performance of the plan was not guaranteed. One could argue that the same would apply to claims arising out of directors' liability and that the plan should not be confirmed unless the investigation and pursuit of a potential Article 2:9 DCC claim is safeguarded. Some possible measures to address the actual investigation and pursuit of such claims will be dealt with below (a liquidating trust).

Pledge

5.31. If an Article 2:9 DCC claim is pledged, this will most likely affect the allocation of value to the various creditor classes (i.e. more value will be allocated to the secured lender), as a result of which for some (unsecured) creditor classes the value in the

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insolvency proceedings of the Plan Company…, consisting of their own possible claims against directors and advisers, is justified as being necessary to enable the Plan to be implemented.'

63 In some other cases, there will be little cause for concern. If, for example, a debt-for-equity swap occurs, the debtor will be controlled by its creditors post-confirmation, and these may in fact have quite a strong incentive to pursue pre-filing directors' liability claims.

64 Art. 384(2)(e) DBA.

65 *Kamerstukken II* 2018/19, 35249, nr. 3, p. 68 en 69.

66 See also Rb. Amsterdam 11 juni 2018, *JOR* 2018/259 m.nt. Van Andel (*Oi*), ECLI:NL:RBAMS:2018:5048.

67 Rb. Rotterdam 9 juni 2022, ECLI:NL:RBROT:2022:12156, Van den Berg & Schreurs, artikel 384, aantekening 3.9.

liquidation scenario may be higher than the value in the reorganization scenario (because an Art. 2:248 DCC claim cannot be pledged). If these creditors oppose the confirmation of the plan, they could do so relying on the best interests of creditors test. The consequences of a pledge on an Article 2:9 DCC claim for the allocation of value are very much fact dependent and therefore no general statements will be made here.

Liquidating Trust/Claim Foundation

5.32. It is argued, or feared, that addressing irregularities may not be possible within the limited timeframe available in a WHOA proceeding.[68] In one sense, this fear is not justified. After all, an Article 2:9 DCC claim or a tort claim involving directors' liability is an *asset* of the debtor and does not disappear after the confirmation of a plan (unless and to the extent a discharge of the directors is included in the plan, see para. 5.24 and further). In theory, there is plenty of time to investigate and pursue such claims post-confirmation of the WHOA plan. Where time constraints do apply, it is in relation to the identification of potential claims and the determination of the value of such claims for the purpose of the confirmation decision.

5.33. Nonetheless, there will understandably be concerns whether the debtor will in fact pursue any directors' liability claims post-conformation. These concerns will be particularly acute if the shareholder remains in place post-confirmation. These concerns can be addressed if the directors' liability claim can be construed as an Article 2:9 DCC claim (or a tort claim held by the debtor). In that case, the claim can simply be transferred to a third party, investigated by that party and – if the expectation is that the Article 2:9 DCC claim has sufficient value – pursued by that party for the benefit of the relevant stakeholders after which the proceeds are distributed in accordance with the WHOA plan.[69]

5.34. There is precedent in WHOA case law for a transfer of assets to a third party to optimize proceeds for the stakeholders, albeit that the asset was not a directors' liability claim. In the Steinhoff case, subsidiaries of the debtor were transferred to a newly incorporated company (Steinhoff Topco B.V.) in order to allow for a controlled sales process.[70] The plan provided that the transferee would issue new contractual rights (*contingent value rights*) to stakeholders in accordance with

68 Vgl. L. Van Dieren-Muller & M. Butot, 'De herstructureringsdeskundige: poortwachter tegen misbruik', *HERO* 2022/P-011, para. 5; Elferink, a.w., para. 3.

69 See also van Nielen e.a., a.w., para. 6.

70 Rb. Amsterdam 21 juni 2023, *JOR* 2023/224 (*Steinhoff*), ECLI:NL:RBAMS:2023:4152, rov. 3.14.

the plan. There is nothing that prevents the same treatment for Article 2:9 DCC claims or tort claims of the debtor.

5.35. In fact, Chapter 11 of the US Bankruptcy Code explicitly provides for such a mechanism. Article 1123(b)(3) of the US Bankruptcy Code reads as follows (emphasis added):

> Subject to subsection (a) of this Article, a plan may … provide for … the retention and enforcement by the debtor, by the trustee, or by <u>a representative of the estate</u> appointed for such purpose, of any such claim or interest.

5.36. Over the years, a quite extensive practice has evolved in the US in which assets that cannot be easily liquidated are transferred to a liquidating trust. The paramount utility of a trust is that it supports the US Bankruptcy Code's intent to speed up a debtor's reorganization. The 9th Circuit held as follows:[71]

> [The] aim [of Article 1123(b)(3)(B)] was to make possible the formulation and consummation of a plan before completion of the investigation and prosecution of causes of action such as those for previous insider misconduct and mismanagement of the debtor. Thus, the statute was in furtherance of the purpose of preserving all assets of the estate while facilitating confirmation of a plan.[72]

5.37. In short, a liquidating trust allows a debtor to transfer causes of action and other assets to the trust for future liquidation and distribution to the debtor's creditors, who are the trust beneficiaries.[73]

5.38. A Chapter 11 case that had some Dutch elements to it was the Chapter 11 case for Mercon B.V. In this case, the debtor also opened WHOA proceedings but ultimately did not present a WHOA plan. In that Mercon Chapter 11 case, a liquidating trust was established, providing:[74]

> The primary purpose of the Trust is to liquidate its assets and make distributions in accordance with the Plan, Confirmation Order and the

71 https://media.gibbonslaw.com/files/publication/4fea6809-63aa-4ae1-b631-d44e96258c64/presentation/publicationattachment/5a5132b7-4982-4cc8-a663-d88fff718cda/ulrich.pdf.
72 In re Acequia, Inc., 34 F.3d 800 (9th Cir. 1994).
73 https://cl.cobar.org/wp-content/uploads/2021/02/March2021-Bankruptcy-Law.pdf.
74 https://cases.ra.kroll.com/MerconLiquidatingTrust/.

Liquidating Trust agreement, with no objective to continue to engage in the conduct of a trade or business, except to the extent reasonably necessary to, and consistent with, the liquidating purpose of the Trust. Among other powers, the Trust is established to investigate and, if appropriate, pursue causes of action assigned to the Trust and resolve disputed claims.

5.39. In the Dutch context, the most obvious structure would be that it is provided in the plan that directors' liability claims held by the company are transferred to a foundation (*stichting*), along with a copy of the books and records for further review and a budget.[75] This foundation can further investigate whether any potential claims are worth pursuing, while not being restrained by the compressed timeframe of WHOA proceedings.

5.40. An alternative structure, or an additional layer of control, could be created by the Court appointing a restructuring expert. The Court may, in its decision on the confirmation of the plan, determine that a previously appointed restructuring expert shall remain in office for a certain period of time.[76] The Court may, for instance, make use of this possibility if it deems it desirable for the restructuring expert to also oversee the implementation of the plan.

5.41. The involvement of such an independent third party is a well-known phenomenon in the English scheme practice. The appointment of such a 'scheme administrator' may be desirable if there is a suspicion of negligence or misfeasance surrounding the management. The role of a scheme administrator is not regulated by law. Accordingly, their powers are contractually defined, partly within the scheme itself and partly in a separate agreement between the company and the administrator.[77] It is possible to create a similar structure in a WHOA plan.

Conclusion as to directors' liability under the WHOA

5.42. In theory at least, the WHOA cannot be an instrument to wipe potential directors' liability issues under the rug. Potential directors' liability claims constitute assets of the debtor that must be accounted for in the liquidation scenario and, where appropriate, the reorganization scenario. This is not different in case the proposed plan is a so-called liquidation plan.

75 Hinted at by Nieuwesteeg & Peters, 'De WHOA en het (on)regelmatighedenonderzoek', in *Wet Homologatie Onderhands Akkoord*, 2021, para. 13.3 with reference to the Slotervaart insolvency.

76 Art. 371(10) DBA.

77 See for all this Mennens, a.w., para. 621.

5.43. The existence of directors' liability claims is relevant in determining the reorganization value and may therefore influence both the confirmation decision and the allocation of value to stakeholders in the WHOA plan. In the event that the reorganization value includes directors' liability claims, the Court should consider whether the performance of the plan is sufficiently guaranteed and the claims are pursued. A liquidating trust will allow time and opportunity to review and pursue potential Article 2:9 DCC claims, allowing the WHOA proceedings to continue.

5.44. Whether this theoretical framework will also be effective in practice will be discussed in more detail below in Chapter 9 where the options are discussed for stakeholders to gather information about potential pre-filing irregularities.

6. Undervalue

Introduction

6.1. In the previous chapter, some suggestions were made as to how to deal in WHOA proceedings with potential directors' liability claims for pre-filing acts. In this chapter, the attention is turned to pre-filing irregularities that may lead to transaction avoidance (*actio Pauliana*). Two types of grounds for transaction avoidance (i.e. two types of detrimental acts) will be discussed in more detail. These are (i) transactions at undervalue (this Chapter 6) and preferential treatment of (certain) creditors (Chapter 7). Above the overall framework of transaction avoidance has been introduced. Here it is reminded that outside of bankruptcy there is only the possibility under Article 3:45 DCC to invoke transaction avoidance against *voluntary* legal acts. Therefore, the assumption will be that the transaction at an undervalue and the preferential treatment constitute such a voluntary legal act.

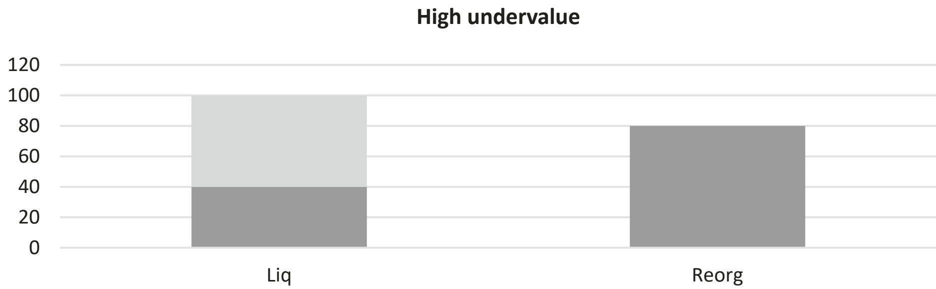
6.2. In turning from directors' liability claims to transaction avoidance, it is important to stress once again that an important difference between the two categories is that the debtor itself may have directors' liability claims, while it cannot not have transaction avoidance actions at its disposal (for its own legal acts). Such actions only pertain to creditors or, in the case of a bankruptcy, to the bankruptcy trustee.

Transactions at an undervalue in the liquidation scenario

6.3. The first category of detrimental acts consists of transactions at undervalue. As will be set out below, the procedural consequences of avoidance actions for transactions at undervalue differ materially from preferences.

6.4. For the purpose of this paper, a transaction at undervalue is deemed to occur when the debtor transfers an asset for a price that is considerably lower than its true value, which transfer can be subject to transaction avoidance under Dutch law.[78] A transaction at undervalue always involves a third party who receives the asset (the **counterparty**).

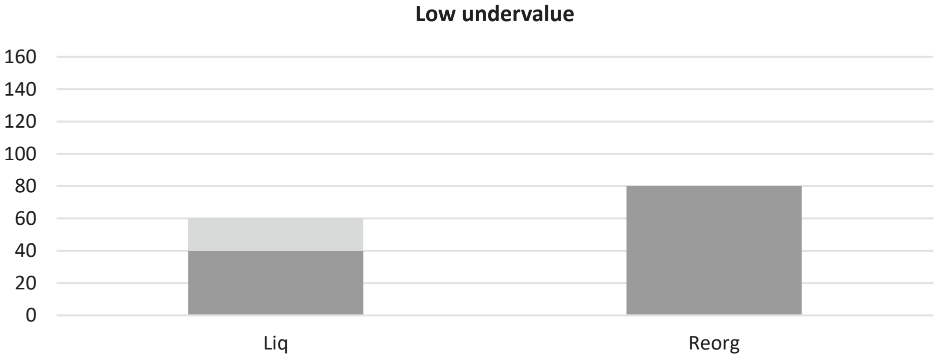
6.5. The value of such potential avoidance action in bankruptcy (Art. 42 DBA) should of course be included in the determination of the WHOA liquidation value. If the value of the avoidance action is high, the outcome of the analysis may be as follows:



As in this 'high undervalue transaction' the liquidation value including the transaction avoidance is higher than the reorganization value, it is highly likely that some creditors can rely on no creditor worse off test to oppose the plan. In that case, this proposed plan probably cannot be confirmed following such objections.[79]

6.6. One could argue that if the liquidation value, including the value of the avoidance action, is lower than the reorganization value, the Court may simply confirm the proposed plan if the formal requirements for confirmation are met:

78 Art. 42 DBA, Art. 3:45 DCC.
79 Art. 384(3) DBA, best interests of creditors.



6.7. This argument, however, reduces the confirmation test to little more than the no-creditor-worse-off test (proceeds for creditors are higher than in the liquidation scenario). Obviously, the test is more complicated, especially where it concerns the distribution of the reorganization value, and I imagine that there may be cases where the Court will hesitate to confirm such plan. After all, as a result of the transaction at undervalue, the reorganization value is lower than it should have been (had the transaction at undervalue not occurred).[80] From that perspective, the reorganization value does not reflect the value that should be available for the creditors. This has two potential consequences:

a. The debtor entity is worth less as a result of the transaction at undervalue and therefore the creditors, taken as a whole, will not receive what should be available to them;
b. The lower reorganization value (as a result of the transaction at undervalue) may lead to the impairment of classes that would not be impaired if the transaction at undervalue had not taken place. Or, in WHOA parlance, as a result of the transaction at undervalue the value now breaks in a different (higher-ranked) class, leaving the lower class with, in principle, no entitlement to value.

<u>Article 2:9 DCC claim in reorganization scenario</u>

6.8. Applying avoidance actions to transactions at undervalue in the liquidation scenario is, however, only half of the story.

80 See also See van Nielen e.a., a.w., para. 4.

6.9. As referenced in Chapter 2 above, the Restructuring Directive references transactions at undervalue in the context of management decisions.[81] At the very least, this suggests that the Restructuring Directive allows that directors who perform acts that are detrimental to the interests of creditors may be held personally liable.

6.10. This is also generally accepted under Dutch law (emphasis added):[82]

> The question of whether there can be concurrence between a potential *actio pauliana* and the remaining liability actions under Articles 2:9 and 2:138/248 BW has … been affirmatively answered by the Dutch Supreme Court in the case of Van Essen q.q./Aalbrecht. In the case underlying this decision, the trustee had initiated proceedings on all conceivable legal grounds….
>
> The trustee based these claims on the allegation that the directors had paid certain due and payable debts shortly before the bankruptcy and had transferred assets without obligation to other group companies…. The Supreme Court held…:
>
> that a payment by [the debtor] and a gratuitous transfer of its assets to [the counterparty], also in light of Articles 42, 43, and 47 DBA and Article 343 of the Dutch Penal Code, may be regarded as an unlawful act by its directors and/or as improper performance of their duties within the meaning of Article 2:248 BW….
>
> From the foregoing, it is evident that the possibility of invoking the *actio pauliana* – whether successfully or not – because the core of the allegation concerns prejudicial actions against creditors, does not in principle exclude liability actions. <u>The trustee or individual creditors may choose from the actions available to them</u>….
>
> The claim under Article 6:162 BW (unlawful act) may, among other things, be directed against counterparties involved in actions that harm the creditors of the company, as well as against the directors of the company itself and the directors of the counterparty with whom the company

81 Recital 71 RD.

82 B.A. Schuijling, e.a. *Aansprakelijkheid van bestuurders en commissarissen* (Serie vanwege het Van der Heijden Instituut te Nijmegen nr. 140), 2017/15.3:15.3 Pauliana en aansprakelijkheidsacties naast elkaar.

engaged in such harmful actions. Claims may also be brought against the directors of the company under Articles 2:9 and 2:138/248 DCC.

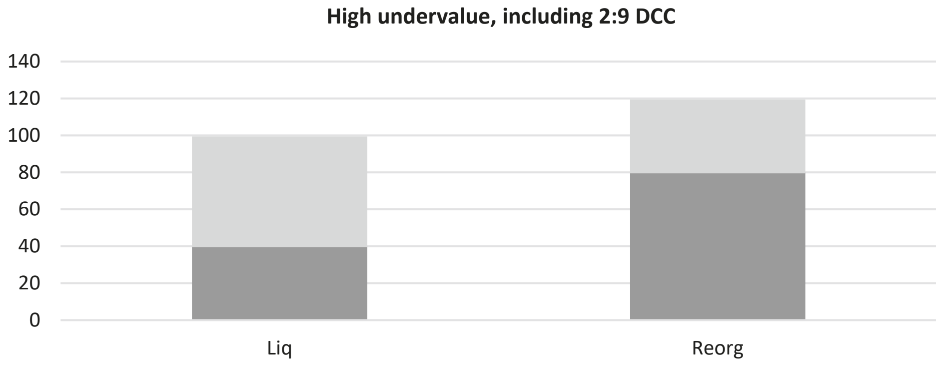
6.11. The test for an Article 3:45 DCC action is clearly different from an Article 2:9 DCC claim or a tort claim held by the company, and, of course, these tests need to be met for the actions to have effect:[83]

> It may be tempting, but it is incorrect, to extend the reasoning established in the Dutch Supreme Court case Van Dooren q.q./ABN Amro I (if not fraudulent under the *actio pauliana*, then in principle not unlawful) in the opposite direction (if fraudulent under the *actio pauliana*, then in principle unlawful). It cannot be asserted that every act that qualifies as fraudulent under the *actio pauliana* constitutes unlawful conduct by the counterparty. A fortiori, it cannot be asserted that every fraudulent act under the *actio pauliana* constitutes unlawful conduct by the director. A director is not necessarily deemed to have acted unlawfully merely because it has been established that he or she engaged in an act subject to avoidance under the *actio pauliana*. The applicable test is whether the director can be personally reproached to a sufficiently serious degree…. Already cases where there is presumption of proof against the counterparty, provide a case against automatically assuming directors to be personally liable as well.

6.12. Having created clear conceptual space between transaction avoidance on the one hand and directors' liability at the other, I do believe that transactions at considerable undervalue as sanctioned by Articles 42 DBA Article 3:45 DCC in many cases would also lead to a claim of the company against its director(s) based on Articles 2:9 and/or 6:162 DCC.

6.13. In the example of the 'high undervalue transaction' (para. 6.5 above), including an Article 2:9 DCC claim in the reorganization scenario may lead to the following outcome, rendering the reorganization value much more attractive:

83 R.J. de Weijs, *INS Updates*, Rb. Gelderland 18 maart 2015, ECLI:NL:RBGEL:2015:2210.



6.14. Moreover, the doubts that the Court may have in relation to the amount of the reorganization value and the ensuing distribution of value (see para. 6.7 above) should be eased by including the Article 2:9 DCC claim in the reorganization value.

6.15. Whether or not in a particular case the value of a claim based on Articles 2:9 and/or 6:162 DCC is of equivalent (or sufficient) value is for the stakeholders to assess. The outcome depends to a large extent on the merits of an Article 2:9 DCC claim and the actual recourse that can be taken against director and the counterparty, respectively. If the stakeholders are of the opinion that the reorganization scenario including the Article 2:9 DCC claim has more value than the liquidation scenario, they may want to push for the creation of the Dutch equivalent of a liquidating trust to pursue the Article 2:9 DCC claim post-confirmation.

6.16. Note that not pursuing the avoidance action will mean that the counterparty may get to keep the asset it acquired at undervalue and the financial burden will fall more heavily on the director.

The Article 3:45 DCC avoidance should not be included in the plan

6.17. It is important to note here first and foremost that the starting point is that the value of a potential Article 2:9 DCC claim that arises out of a transaction at undervalue should be included in the reorganization value and the Article 2:9 claim should be pursued in order to realize the reorganization value.

6.18. Notwithstanding the Article 2:9 DCC claim in the reorganization scenario, creditors may – before confirmation of the plan – decide to avoid the transaction at undervalue on the basis of Article 3:45 DCC because such transaction is detrimental to creditors. Although such avoidance is certainly relevant for the various stakeholders, it is likely that the proposed plan should ignore the Article 3:45 DCC avoidance. The reason for this is the relative effect of the Article 3:45 DCC avoidance action (see para. 3.19 and further above).

6.19. As a result of the relative effect of an Article 3:45 DCC avoidance action, the avoiding creditor may have entitlements based on an Article 3:45 DCC action, but creditors that have not avoided the transaction at undervalue would not have such entitlements. In relation to the non-avoiding creditors, the transaction at undervalue would remain valid. For this reason, it seems likely that a 3:45 DCC avoidance action in relation to a transaction at undervalue does not influence the reorganization value of the debtor.[84] The reorganization value is, after all, the distribution of the value of the debtor that is available to *all* creditors.[85]

6.20. As an aside I note that it is not quite clear how an Article 3:45 DCC action is to play out if the plan is confirmed and does not provide any arrangement for such avoidance.[86]

6.21. On the flipside, not including the value of any Article 3:45 DCC avoidance actions in the reorganization value obviously does not help in having the plan confirmed. In case the Article 2:9 DCC claim has no value (e.g. the director is broke and uninsured) and the liquidation value is significantly higher than

84 See also vgl Rb Zeeland-West-Brabant 22 april 2025, ECLI:NL:RBZWB:2025:2652: 'The Court concurs with [the applicant] that the insurance payment should not be included in the reorganization value. This payment does not increase the value of the enterprise, as it constitutes earmarked funds, specifically intended for distribution to the parties injured by the insured event.'

85 Art. 375(1)(e) DBA refers to: 'the value that is expected to be realised if the restructuring plan is put into effect' and Art. 384(4) DBA to 'the distribution of the value realised with the restructuring plan'. This is explained as follows in the preparatory works: 'In subsection e of the first paragraph, it is stipulated that the agreement must include information regarding the "value that is expected to be realized if the agreement is implemented". This provision refers to the value that can be preserved or realized for creditors and shareholders through the execution of the agreement. In US practice, this is commonly referred to as the "reorganization value…."' In my view, the structure of the WHOA requires that the reorganization value is equal for all stakeholders.

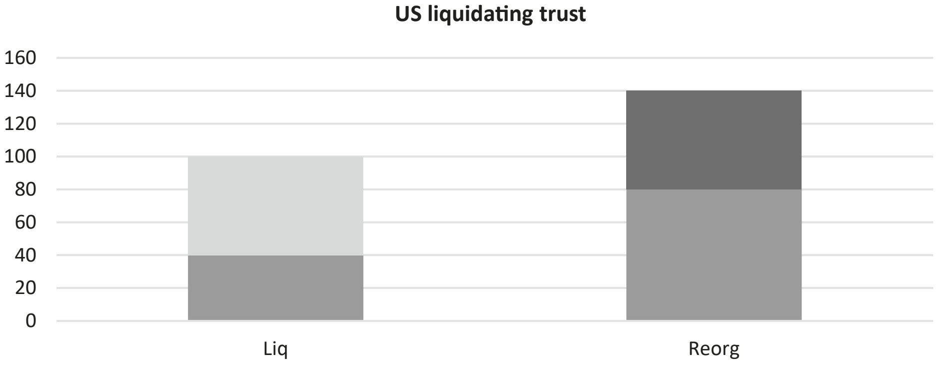
86 Strictly spoken, the avoiding creditor does not pursue a claim against the counterparty. As a result of the avoidance action (if successful), in relation to the avoiding creditor the asset is still considered an asset of the debtor and therefore the avoiding creditor has to pursue a claim not against the counterparty, but against the debtor. This raises the question whether the avoiding creditor can still do so following confirmation of a WHOA plan. Say, for example, that the avoiding creditor has a claim of 100 against the debtor, and a plan is confirmed in which his claim is reduced to 20, which claim is subsequently paid in full. Does the avoiding creditor still have a claim against the debtor on the basis of which they can take recourse against the asset? Note that if that is not the case, the counterparty is lucky because they get to keep the asset acquired at an undervalue. One option is of course that the plan does make provisions for the avoiding creditor, in the sense that its claim is reduced to 20 and that they maintain a claim for the remaining 80 to the extent the avoiding creditor can take recourse on the relevant asset(s). See Art. 160 DBA and J.W. Frieling, 'Pauliana-acties na faillissementseinde', *TvI* 2001/3, p. 143 e.v.

the reorganization value because of the potential Article 42 DBA avoidance in bankruptcy, the plan may still be doomed. Is there another way to generate value for the creditors and potentially make the plan work?

Liquidating trust and transactions at undervalue

6.22. In the US, the liquidating trust is a tool commonly used by bankruptcy practitioners to recover avoidable transfers.[87]

6.23. Going back to the first example (the high-value-transaction avoidance claim), a US liquidating trust could recover the avoidable transactions, thereby creating additional value in the reorganization scenario. The value of the asset subject to transaction avoidance is represented by the grey column:



6.24. This is unfortunately at this time not a feasible option in the Netherlands. Avoidance actions based on Article 42 or 47 DBA simply do not come into existence if a bankruptcy is avoided through confirmation of a WHOA plan. Article 3:45 DCC actions are not assets of the debtor that can be transferred as such by the debtor to a liquidating trust or a claim foundation. But could an alternative approach lead to the same effect?

6.25. If one or more creditors invoke Article 3:45 DCC and avoid the transaction at undervalue, the grey element in the above chart would likely still not be considered additional reorganization value, but it would be value that is available

87 See, for example, *In re: F-Squared Investment Management, LLC*, 633 B.R. 663 (Bankr. D. Del. 2021) and *In re: Boston Generating LLC*, 2024 WL 4234886 (2nd Cir. 19 September 2024). In both these cases, the avoidance was ultimately unsuccessful.

to creditors who have avoided the transaction at undervalue (the relative effect of an Art. 3:45 DCC avoidance action).

6.26. To give all creditors what is due to them in the reorganization scenario, one could contemplate a scenario in which *all* creditors avoid that transaction at undervalue. Such 'joint avoidance' by all creditors may not be easily organized.

> It is not possible to provide in the plan that (a representative of) the creditors can invoke the bankruptcy avoidance action (Art. 42 DBA).[88] Each creditor has its own Article 3:45 DCC action (or tort claim on the counterparty[89]).

6.27. However, it is generally held that if the claim against the debtor is assigned, the right to invoke Article 3:45 DCC then lies with the assignee. See, for example, Bartstra:[90]

> [The assignee] is, after all, now a creditor whose possibilities of recourse are prejudiced by the legal act to be avoided. The fact that the assignee was not the holder of the claim at the time the legal act to be avoided was performed does not preclude this. After all, Article 3:45 DCC grants any creditor whose possibilities of recourse are prejudiced, under certain circumstances, the right to annul the prejudicial legal act….[91] [I]t is not required that the debtor and the counterparty knew or ought to have known that it was precisely this creditor whose possibilities of recourse would be prejudiced by the legal act. The right to invoke the *actio pauliana* differs from the right to claim damages for tort in that the right to damages is granted to the person against whom the wrongful act was committed, and not to the holder of the claim that has remained unpaid as a result. The right to invoke the *Actio Pauliana* is, on the contrary, granted to the

88 See Mennens, a.w., para. 7.3.8 with reference to Hof Den Haag 10 februari 1919 W10468.
89 HR 28 juni 1957, *NJ* 1957/514, m.nt. L.E.H. Rutten (*Erba II*).
90 W.J. Bartsta, 'De rechtspositie van distressed debt investors naar Nederlands recht', *WPNR* 2021/7332, para. 8.
91 Footnotes in the original: Zie bijvoorbeeld: F. Damsteegt-Molier, *Relativering van eigendom*, Den Haag: Boom Juridisch 2009, p. 75; J.W.A. Biemans, *Rechtsgevolgen van stille cessie*, Deventer: Wolters Kluwer 2011, p. 470; T.E. Booms, *Aanvullen van subjectieve rechten*, Deventer: Wolters Kluwer 2019, p. 286; B.S.J.M. van Gangelen & G.H. Gispen, 'Gebruik de onrechtmatige daad niet als de actio pauliana uitkomst biedt', in: W. Schreurs e.a. (red.), *De gereedschapskist van de curator*, Deventer: Wolters Kluwer 2015, p. 13; G.H. Gispen, 'De onrechtmatige daadvordering als complement van de actio Pauliana', in: A. Van Hees e.a. (red.), *Vragen rondom de faillissementspauliana*, Deventer: Wolters Kluwer 1998, p. 49.

holder of the claim whose possibilities of recourse have been impaired by the legal act to be avoided.

6.28. On the basis that an assignee of a claim has the right to avoid transactions by the debtor that took place before the claim was assigned to it, the debtor may consider proposing a plan in which the claims of all creditors that remain unpaid following confirmation of the plan (which are rights of the creditor vis-à-vis the debtor in the sense of Art. 370(1) DBA)[92] are transferred in exchange for an entitlement to the proceeds of the Article 3:45 DCC actions instigated by the assignee against the counterparty.

6.29. Can the debtor propose a plan in which the remaining claims of the creditors are assigned to a liquidating trust to the extent required to take recourse on the asset that was transferred at undervalue? In other words, could a plan be confirmed which provides that these remaining creditor claims are transferred to a liquidating trust, even where it concerns dissenting and inactive creditors, in exchange for a claim on that liquidating trust corresponding with their entitlements to the proceeds of the Article 3:45 DCC action? In my opinion, this should indeed be possible. Because these remaining creditor claims qualify as rights of the creditor vis-à-vis the debtor in the sense of Article 370(1) DBA they can be 'amended'.[93] After all, if shareholders can be forced to transfer their shares,[94] should it not also be the case that creditors can be forced to transfer their remaining claim?

6.30. It will without doubt require careful drafting, but, if the above structure is successfully set up, a liquidating trust can subsequently investigate and pursue an avoidance action against the counterparty regarding a transaction at undervalue for the benefit of all creditors.

6.31. Using a liquidating trust for this purpose also promotes the equality of creditors. The liquidation trust structure prevents that insiders, who know the details of the transaction at undervalue, benefit from avoidance actions that outside creditors are not in a position to substantiate.

92 Such plan is in a sense quite similar to a transfer of shares in a debt-for-equity swap.

93 See also Rb Amsterdam 15 mei 2024, ECLI:NL:RBAMS:2024:3441, *JOR* 2024/211 met annotatie van prof. mr. dr. A.C.P. Bobeldijk (Bio City), par. 5.3.

94 See a.o. M.L.J. Noldus e.a., 'When worlds collide: grenzen aan aandeelhoudersbevoegdheden in de WHOA', *TvI* 2024/34, para. 1.

Conclusion

6.32. As a result of avoidable transactions at undervalue, the liquidation value may be higher than the reorganization value, in which case the plan is likely not confirmed. But even if the reorganization value would be higher, as a result of the transaction at undervalue the reorganization value is lower than it should have been. This may lead to the impairment of classes that would not be impaired if the transaction at undervalue had not taken place. There seem to be two principal routes to giving the stakeholders what is due to them. First of all, in many cases transactions at considerable undervalue lead to a claim based on Articles 2:9 and/or 6:162 DCC which can be pursued in the reorganization scenario. Secondly, it seems feasible have a plan confirmed by which the (unpaid parts of the) claims held by the creditors are transferred to a liquidating trust, after which the liquidating trust – for the benefit of all relevant creditors – starts an Article 3:45 DCC action for the purpose of taking recourse on the asset transferred at undervalue.

7. Preference

7.1. The rules governing the distribution of the proceeds of execution assume that the ranking of creditors takes the form of a hierarchical list. This means that all relative positions of creditors can be consolidated into an ordered list of all creditors. Once this list has been established, the creditors at the highest rank are paid. If any proceeds of execution remain thereafter, the creditors at the second rank receive a portion of those proceeds, and so on. If the proceeds of execution are insufficient to satisfy all creditors of a given rank, they are paid proportionally to the size of their claims. In such a case, each creditor of that rank receives the same percentage of their claim from the proceeds of execution.[95]

7.2. The second category of detrimental acts consists of legal acts which have the effect of improving the position of one or more creditors vis-à-vis other creditors (preferring certain creditors over others). Here I am focussing on the voluntary preferential creation of security rights and not on preferential payments that led to a cash-out.

7.3. The consequences of avoidance actions for preferences differ materially from transactions at undervalue. Note that where avoiding a transaction at undervalue

95 N.B. Pannevis, 'Achtergestelde vorderingen', *AA* februari 2020, p. 215.

increases the value (a larger pie), avoiding a preferential transaction does not necessarily affect the value but rather influences class composition and value distribution (the allocation of pieces of the pie).

7.4. Avoidance of preferential acts outside of bankruptcy is generally a zero-sum game played between creditors. By way of an example, imagine a couple of creditors discussing a plan proposed by their debtor (it is rumoured such example has in fact occurred in real life):

> Creditor V asks Creditor S: 'Hey, it says here on page 5 that you are in the class of secured creditors. I did not know you were a secured creditor. When did that happen?'
> To which Creditor S, an honest man, replies: 'Yeah, we were given collateral just recently. My team did great to agree to this with the debtor just before the filing of the WHOA proceedings.'
> Upon his return to the office, Creditor V avoids the provision of security to Creditor S on the basis of Article 3:45 DCC [by sending a letter to both the creditor and the debtor company].

<u>Complications as to preferences in case of avoiding and non-avoiding creditors</u>

7.5. Affected creditors may consider to avoid the late voluntary creation of security rights, which may heavily influence the composition of classes and allocation of value.

7.6. The analysis of the consequences of such avoidance actions will become quite complicated quite quickly, especially if there are creditors that did and creditors that did not invoke transaction avoidance (this is again a consequence of the relative effect of an Art. 3:45 DCC avoidance action). The exact allocation of value becomes almost impossible to pinpoint. The complexities that arise will be explained in paragraphs 7.8 up to 7.23.

7.7. It is likely that also in practice, discussions on avoidance of preferential acts will become so complicated that either the secured creditor and the other creditors settle, or the plan provides for litigation that can take place after the confirmation of the plan. As such, invoking Article 3:45 DCC is a useful way to force the (newly) secured creditor to the table.

7.8. It has already been observed in literature that the relative effect of the Article 3:45 DCC avoidance of a preferential act can lead to a distortion of the positions of the respective creditors. See on this Pannevis:[96]

> Invoking Article 3:45 DCC can lead to relative changes in rank. If one creditor avoids the creation of a pledge on the basis of Article 3:45 DCC, the pledgee can no longer rely on its preference created against that creditor, but the pledgee can still rely on it (the pledge and the preference it creates, KPH) against other creditors.

7.9. In the example, we have a purportedly secured creditor, an avoiding creditor and a non-avoiding creditor. In case of a (successful) Article 3:45 DCC avoidance action by the avoiding creditor of the provision of security, this leads to the following ranks:[97]

- The rank of the avoiding creditor and the secured creditor is equal (the security has no effect regarding the avoiding creditor);
- The rank of the two ordinary unsecured creditors is equal; and
- The secured creditor has a higher rank than the non-avoiding creditor.

7.10. This can be illustrated as follows:

<table>
<tr><td rowspan="2">Avoiding creditor</td><td>Secured creditor</td></tr>
<tr><td>Non-avoiding creditor</td></tr>
</table>

7.11. These relativity effects render it impossible to determine a 'ranking'.[98] After all, in a traditional ranking such as the Premier League, it is not possible that Liverpool is equal with Arsenal and above Spurs, while Spurs is equal to Arsenal.

7.12. In the event of a bankruptcy or the enforcement on collateral, where it concerns the distribution of cash monies, this is solved by distributing the proceeds in such fashion that the avoiding creditor receives the share of the proceeds it would receive absent the security (a third if all creditors have equal claims) and the rest is shared between the secured creditor and the non-avoiding creditors according to their rank.[99]

96 N.B. Pannevis, 'De structuur van de rangorde', *TvI* 2022/15.
97 N.B. Pannevis, 'De rang van vorderingen', *NTBR* 2023/9.
98 N.B. Pannevis, 'De structuur van de rangorde', *TvI* 2022/15.
99 N.B. Pannevis, 'De rang van vorderingen', *NTBR* 2023/9.

7.13. If, in the example given above, all three creditors have a claim of 50 (150 in total), the proceeds of the secured assets are 90 and the avoidance is legally effective, the avoiding creditor would therefore receive 30, the secured creditor 50 and the non-avoiding creditor 10. If the proceeds would be 60, the avoiding creditor would receive 20 and the secured creditor 40.

7.14. In contrast to this simplified example, in a WHOA plan it is not necessarily the case that creditors receive cash monies equal to a certain percentage of their claim. To the contrary, it is quite common, for example, that creditors receive a financial instrument. In many cases, the secured creditor is asked to postpone the repayment date (maturity) of his claim. One may be tempted to think that if the claim of the secured creditor is only postponed, the claim of the avoiding creditor (which is considered equal to the claim of the secured creditor) should also be only postponed and that the avoiding creditor should not receive a haircut. This is not the case, however. The starting point of the WHOA is that stakeholders receive value corresponding with their rank.[100] Otherwise, the debtor is entirely free to structure the composition plan within the boundaries set forth by the WHOA. This means that the debtor may, in principle, offer one class a percentage-based settlement, another class a debt-for-equity swap, and yet another class full payment, albeit deferred and subject to different terms and conditions.[101] So while the avoiding creditor is 'equal' to the secured creditor, the secured creditor may receive a standstill and higher interest while the avoiding creditor receives a cash payment, as long as the values correspond with their entitlements to value in the above examples.

7.15. This means that the above can also be used for the class composition in a WHOA plan. It is highly likely that the three creditors must be placed into separate classes because either they have differing rights against the debtor, or they receive differing value on the basis of the plan.[102]

7.16. If we take the simple example described above and apply it to a WHOA plan, the value allocated to the three creditors based on two variables (reorganization value 60 or 90, avoidance successful or unsuccessful), this leads to the following table:

100 J.F. Fliek, 'Het (ontbrekende) toetsingskader voor een wijziging van de rangorde door middel van een WHOA-akkoord', *FIP* 2025/4, o.m. para. 3.3.

101 L.F.A. Welling-Steffens, 'De pandhouder en de WHOA', *NTBR* 2023/11.

102 N.B. Pannevis, 'De klassenvorming onder de WHOA en de structuur van Nederlandse rangordebepalingen', *FIP* 2019/216.

	Claim		Avoiding Successful		Avoiding Unsuccessful
Reorg value		60	90	60	90
Secured	50	40	50	50	50
Avoiding creditor	50	20	30	5	20
Non-avoiding creditor	50	0	10	5	20

7.17. This table illustrates a couple of points:

a. First of all, it is noticeable that the value to which the non-avoiding creditor is entitled is different in each of the four scenarios, including zero in one of the scenarios.
b. The value to which the avoiding creditor is entitled varies widely, between 5 and 30.
c. Although the value to which the secured creditor is entitled is the most consistent of the three, it is also not always the same.

7.18. Note that the non-avoiding creditor stands to gain if the security is deemed valid. Conversely, the avoiding creditor stands to gain if the provision of security is indeed deemed avoided. Depending on the reorganization value, the secured creditor may not care either way as the value to which the secured creditor is entitled is fairly consistent (as a result of the relativity of the Art. 3.45 DCC avoidance, the secured creditor still benefits from its preference vis-à-vis non-avoiding creditors). The secured creditor and the avoiding creditor may therefore be tempted to not litigate the transaction avoidance and strike a deal.

7.19. In practice, the chances of a case actually playing out this way are slim. If the creditors are presented with a WHOA plan containing separate classes for avoiding and non-avoiding creditors – as would likely be required – one would assume that (most) other non-avoiding creditors will subsequently also avoid the provision of security, thereby rendering the class composition inaccurate and therefore (likely) not suitable for confirmation,[103] leading to a collapse of the WHOA plan as proposed.[104]

7.20. In order to address these concerns and seek more clarity on the question whether such plan can be confirmed, the debtor may seek guidance from the Court.[105]

103 Art. 384(2)(c) DBA.
104 Ibid., see also L.F.A. Welling-Steffens, 'De pandhouder en de WHOA', *NTBR* 2023/11 and N.B. Pannevis, 'De klassenvorming onder de WHOA en Nederlandse rangbepalingen', *FIP* 2019/216, pp. 35-36.
105 Art. 378 DBA.

7.21. However, even assuming the Court is willing to, and successful in, clearing up issues regarding class composition, voting and the confirmation criteria, the Court cannot – for lack of jurisdiction – ultimately decide whether the avoidance actions are successful or not.[106]

7.22. The question whether the transaction avoidance actions were effective must likely be answered in separate proceedings between the secured creditor(s) and the avoiding creditor(s) (and the debtor). The nature of these proceedings between the various creditor groups implies that creating a liquidating trustee structure is not feasible. In contrast to claims for transactions at undervalue, it is less evident that preferential acts can also lead to directors' liability claims on the basis of Article 2:9 DCC.

7.23. One option that may reduce procedural uncertainty for both the debtor and the creditors is to organize expedited post-confirmation litigation about the validity of security rights. This could entail that (i) the plan has two alternatives (including and excluding the secured creditor) and (ii) the value distributed to each class is different in both scenarios. This should be feasible as WHOA proceedings allow for significant flexibility in respect of the value distributed to stakeholders. This can be illustrated by the structure of liquidation plans in the Netherlands. The Court requires that such liquidation plans are proposed and confirmed before all assets have been liquidated. Liquidating plans must be proposed before the actual process of liquidating the assets of the debtor is completed.[107] In the Steinhoff matter, for example, the plan consisted of a controlled sale of the subsidiaries of the debtor over a three-to-five-year period following confirmation.[108]

Conclusion

7.24. Transaction avoidance for preferential treatment that entails providing security to a creditor cannot be solved by the debtor. It essentially concerns a zero-sum game between the secured creditor(s) and the avoiding creditor(s). One option that may reduce procedural uncertainty for both the debtor and the creditors is to organize expedited post-confirmation litigation regarding the validity of the security rights. It is likely that the WHOA is sufficiently flexible to allow for such alternative value allocations. If such alternatives cannot be included, it will be quite difficult to have a WHOA plan confirmed.

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106 *Kamerstukken II* 2018/19, 35249, nr. 3, p. 58.
107 See M.S. Breeman e.a., 'Kroniek WHOA: 2,5 jaar WHOA-uitspraken', *TvI* 2023/37, para. 2.
108 Rb. Amsterdam 21 juni 2023, ECLI:NL:RBAMS:2023:4152, *JOR* 2023/224 (*Steinhoff*).

7.25. The Court should pay particular attention to the class composition for voting purposes. In principle, there should be separate classes for the secured creditor(s), the avoiding creditor(s) and the non-avoiding creditor(s). The plan itself should allow for at least two alternatives, one in which the security is valid, and one in which it is not. In addition, the Court should carefully review the value allocated to the non-avoiding creditors in the liquidation scenario.

8. Avoidance of Obligatory Legal Acts

8.1. In addition to the above, there are (limited) grounds for a Dutch bankruptcy trustee to avoid obligatory legal acts, that is, the performance of an act which the debtor could be legally enforced to perform.[109]

8.2. An obligatory act by the debtor can only be challenged by a bankruptcy trustee, if:[110]

a. It prejudices the available means of recovery of one or more creditors; and,
b. either
   i. the act took place at a moment when the claimant of the obligation knew that a bankruptcy petition with respect to the debtor had been filed with the court; *or*
   ii. the payment was the result of collusion between the debtor and the creditor with the intention of preferring that creditor over other creditors.

8.3. Ground b(i) will not be relevant during WHOA proceedings and will likely not be relevant at all.

8.4. Ground b(ii) has in practice morphed into a restriction on related-party transactions. The court may presume that (unless the contrary is proven by the creditor) such collusion took place if the debtor and the creditor that was paid were related parties in the sense that the management of the debtor and the management of the creditor are 'in the same hands' and the debtor is already facing a very bad financial situation.[111]

8.5. By way of an interim conclusion, there is a strong case that insofar relevant at all, avoidance of obligatory legal acts is in practice only relevant in relation to certain

109 Art. 47 DBA.
110 HR 22 maart 1991, *NJ* 1992.214 (*Loeffen q.q. v. BMH II*), also: Polak/Pannevis, Insolventierecht, p. 148.
111 HR 7 maart 2003, *NJ* 2003/429 (*Cikam v. Siemon q.q.*).

related-party transactions. Therefore, in case of obligatory legal acts outside the scope of related parties, there is de facto very little downside to not having a bankruptcy trustee reviewing the potential applicability of these avoidance actions. Related-party transactions pose bigger problems and will be discussed in more detail in Chapter 10 below.

Part B – Information Gathering

9. Ex ante Information Provision

9.1. All the above theories and ideas about addressing pre-filing irregularities in WHOA proceedings remain just that – theories – if stakeholders are not able to find out, before the confirmation hearing, that the irregularities even took place.[112]

Negotiations

9.2. Before diving into legal options for gathering information, it is worthwhile to stress that WHOA proceedings are supposed to be *negotiations*. These negotiations take place between the debtor and the relevant stakeholders. In these negotiations, the debtor is the asking party. It wants something from its stakeholders. This setting gives leverage to stakeholders and stakeholders should use this leverage.

9.3. Stakeholders would be well-advised to consider the information gathering options they have which do not involve the Court. If and when approached by the debtor, the stakeholders can ask questions to the debtor. The stakeholders can ask for information that pertains to potential irregularities. Stakeholders can hire advisers (including lawyers who take appointments as bankruptcy trustee) and organize an 'intake', asking questions about any recent refinancing efforts, security provided to lenders, related-party transactions, developments in accounts receivable positions and so on.

9.4. The debtor may refuse to share this information (to the extent it is not obliged to share this information in the WHOA proceedings[113]). But this is a risky strategy for the debtor because if there are no compelling reasons for not sharing the

112 See, for example, Berghuijs, a.w. para. 14.2.8, Van Nielen e.a., a.w., J.A. van der Meer, 'Misbruik van de WHOA', *FIP* 2021/1.
113 Art. 375 DBA.

information, it may (and should) cause creditors to vote against the proposed plan, to ask for a restructuring expert or suggest the appointment of an observer and/or file a statement arguing against confirmation. The Court will certainly be interested in learning more about the denial of information. The Court expects that stakeholders who are of the opinion that the information provided is insufficient will vote against the plan or abstain.[114]

The Court – WHOA Pool

9.5. It is noteworthy that the decision to create a 'WHOA pool' of experienced bankruptcy judges from all district courts in the Netherlands to deal with all WHOA cases has turned out well for a number of reasons. One of these reasons, I would argue, is that these bankruptcy judges spend much time supervising bankruptcies and as such are in contact with bankruptcy trustees on a daily basis. They are therefore well aware of the issues that bankruptcy trustees deal with and the irregularities they encounter.

9.6. In other words, the judges in the WHOA pool are experienced and will scrutinize information provided by the debtor that is not conclusive. For example, in one case the Court decided to deny confirmation because of inaccurate information, although the plan was accepted by all classes and no stakeholder argued that confirmation should be denied.[115] That the Court nonetheless decided to deny confirmation shows that the Court is rightfully sceptical of the arguments put forward by the debtor and is willing to make its own analysis of the case. It is fair to say that this decision illustrates that if there are legitimate concerns regarding the potential existence of irregularities, the Court will act on these concerns. Having said that, the Court has repeatedly held that it is not its job to approve (or disapprove) the information provided to creditors and that it is up to the creditors to assess the quality of the information provided.[116]

Information provision

9.7. As pointed out at paragraph 5.24 and further, Article 375 DBA likely obliges debtors to include (material) irregularities that took place before the filing of the WHOA proceeding in the analysis of the liquidation (and where applicable: reorganization) value.

114 See a.o. Rb. Midden-Nederland 4 maart 2025, ECLI:NL:RBMNE:2025:932, para. 5.5.
115 Rb. Oost-Brabant 27 augustus 2021, *JOR* 2022/16, m.nt. Salah, ECLI:NL:RBOBR:2021:4818.
116 See a.o. Rb. Oost-Brabant 27 augustus 2021, *JOR* 2022/16, m.nt. Salah, ECLI:NL:RBOBR:2021:4818, rov. 5.1, 5.5.

9.8. The Court already specifically decided that Article 375(1) under e, f and g DBA was breached in a case where, just prior to the opening of the WHOA proceedings, a transfer took place of assets, employees, customers and suppliers to a third party – and it denied confirmation.[117]

Ex ante information review

9.9. It cannot be excluded that certain debtors will not provide the required information regarding (material) irregularities and will simply state that no irregularities took place.[118] For that reason, some authors argue that a 'quick scan' should take place in each and every WHOA proceeding that is filed.[119]

- In literature, there are numerous references to a 2005 report is which it was found that in 25% of the bankruptcies 'bankruptcy fraud' (including detrimental acts) took place pre-filing.[120] If suspicions of mismanagement are included in the assessment, irregularities are found to have taken place in a whopping 43% of the bankruptcies. According to the authors of the report, the average damages in bankruptcies involving bankruptcy fraud is no less than EUR 600,000.[121]
- If these findings are accepted as the truth, it is easier to understand the calls to have an investigation into potential irregularities in each and every insolvency. Nonetheless, I don't think this report should be given too much weight for our current discussions. First of all, it is 20 years old and some questions have been raised as to both its methodology and findings regarding the (frequent) occurrence of irregularities.[122] Moreover, it is noteworthy that bankruptcy trustees filed claim in only 20% of the cases investigated by the authors.[123] The most important reason not to take any action in 80% of the cases was stated to be lack of recourse with directors of the company. It is therefore safe to say that many of these purported claims clearly had no monetary value.

117 Rb. Oost-Brabant 27 augustus 2021, *JOR* 2022/16, m.nt. Salah, ECLI:NL:RBOBR:2021:4818.
118 The asymmetric information positions in this regard are considered by many to provide avenues for misuse of the WHOA, although concrete examples of such misuse are not available, Verstijlen, a.w., p. 138.
119 Van Nielen e.a., a.w., p. 17 e.v.
120 R. Knegt e.a., *Fraude en Misbruik bij faillissement: een onderzoek naar de aard en omvang*, WODC Rapport 1199, 2005. In te zien via https://zoek.officielebekendmakingen.nl/kst-27244-25-b1.pdf.
121 R. Knegt e.a., 'Faillissementsfraude en de rol van de curator', *TvI* 2006/19.
122 See a.o. M. Beke e.a., *Verkenning naar aanpak bestrijding van veelplegers van faillissementsfraude*, WODC Rapport 2021, R.F. Feenstra, 'Bestrijding van Faillissementsfraude, op zoek naar het juiste spoor', *TvI* 2015/14, para. 6;. W. Aerts, 'Bestrijding van faillissementsfraude: de stand van zaken', *TvI* 2006/18, p. 75.
123 Knegt e.a. 2005, p. 114.

9.10. A quick scan in each and every WHOA proceeding would be an enormous burden on debtors and would significantly hamper the fast, efficient and flexible operation of the WHOA.[124] Moreover, an investigation into the causes of the insolvency of a company and the occurrence of any irregularities is exceptional and is only required in a Dutch bankruptcy.[125] And even in bankruptcy, the central role of the bankruptcy trustee in addressing irregularities is controversial.[126]

9.11. An investigation into the causes of the bankruptcy does not take place in the event a consensual deal is entered into and neither does it take place when a company is in suspension of payments and successfully proposes a composition in that proceeding. In that sense, I am not convinced that considerations in relation to 'the interests of society' should be relevant in the decision whether or not to confirm a WHOA plan.[127]

9.12. Some authors point to 'unknown unknowns' as a reason for caution. These authors point out that transaction avoidance actions (Art. 42 DBA) may arise even if the debtor and its counterparty did not intend any detriment and were not aware of this.[128] This is, of course, true, if only because the definition of knowledge is also objective ('should have known'). It may well be that a bankruptcy trustee, if appointed, can bring detrimental acts to light that no one was aware of. Confirmation of a WHOA plan would indeed prevent such findings. In my view, that is a downside that can easily be accepted. If no one, including the debtor, is aware of potential detrimental acts, no one is disappointed if it is not investigated.

<u>Liquidation plans</u>

9.13. It is feared that bad faith actors will specifically use liquidation plans to avoid directors' liability or transaction avoidance actions.[129] There is, however, no

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124 Berghuijs, a.w. para. 14.2.8.

125 Art. 68(2) DBA.

126 J.M.W. Pool, *De rol van de curator bij de aanpak van onregelmatigheden: een empirisch-juridisch onderzoek naar de rol van de curator in de praktijk bij de aanpak van onregelmatigheden voor en tijdens faillissement*, 2022, p. 207: 'However, the task of the bankruptcy trustee is not without controversy, mainly because the bankruptcy community does not agree with the legislator's assumption that the task of dealing with irregularities is an extension of the bankruptcy trustee's core task of liquidating the estate in the interest of the joint creditors. After all, it is not always in the interest of the joint creditors to address irregularities, because in some situations the costs of investigating and redressing irregularities do not outweigh the (potential) benefits.'

127 Vgl. P.J. Neijt, 'Meer houvast voor de observator: de Leidraad voor de observator', *TvI* 2025/; Neijt & Broekema, a.w.

128 Nieuwesteeg & Peters, a.w., hoofdstuk 13.

129 Verstijlen a.w., p. 93.

principal difference in dealing with pre-filing irregularities in a liquidation WHOA or in a 'restructuring' WHOA.

9.14. In relation to liquidation plans, there is an added layer of protection in the sense that the Court has introduced an additional requirement for confirmation. A liquidation plan is only eligible for confirmation only if it provides 'added value' to the stakeholders over and above a liquidation in bankruptcy, taking into account that an investigation into irregularities will not take place if the plan is confirmed.[130] This test is stricter than the best interests of creditors test and is applied by the Court irrespective of any objections by stakeholders. In one case, for example, the Court held that it cannot be excluded that fraud took place by the debtor in relation to certain requests for subsidies and that, as a result, it cannot be excluded that the debtor may have claims based on these irregularities.[131] It could not be established that an investigation of these irregularities in a bankruptcy would not lead to any proceeds and, as a result, the added value of the liquidation plan was deemed insufficiently demonstrated.

- Note that the fraud claims likely exist regardless of a bankruptcy of the debtor and that the debtor can collect these also following a WHOA plan. However, it seems the debtor did not intend to collect these fraud claims in the context the liquidation plan.

9.15. In another decision, the Court questioned the added value of the liquidation plan, among other things, because a bankruptcy provides more safeguards in relation to an investigation into irregularities such as directors' liability and transaction avoidance.[132] The decision does not actually mention any potential or suspected irregularities. Likewise, in the context of a request for a cooling-off period, the Court appointed an observer on the basis that, among other things, an investigation into irregularities as carried out in a bankruptcy would not take place if the liquidation plan was confirmed and that therefore the added value of the liquidation plan was uncertain.[133]

9.16. More information about a potential claim arising out of irregularities was provided in a 2022 case. The Court held that it was insufficiently clear that the liquidation plan would create added value because in the context of a liquidation plan, no

130 Rb. Rotterdam 8 maart 2021, *JOR* 2021/247, m.nt. Mennens, r.o. 4.6-4.9 en Rb. Amsterdam 23 maart 2021, *JOR* 2021/218, m.nt. Harmsen.

131 Rb. Rotterdam, 8 maart 2021, JOR 2021/247, m.nt. A.M. Mennens.

132 Rb. Noord-Nederland, 15 november 2021, *JOR* 2022/50, m.nt. R. van den Sigtenhorst, ECLI:NL:RBNNE:2021:5106.

133 Rb. Rotterdam 7 februari 2022, ECLI:NL:RBROT:2022:12203.

investigation into irregularities takes place.[134] The Court takes into account that the employee costs in 2021 were almost three times as high (EUR 304k) as those in 2020 (EUR 112k), which increase, according to the director, was caused by 'a review of the wage bill'. In response to questions from the Court, it turned out that the increase was caused by additional wages for the director. The concerns about irregularities were shared with the Court by a creditor, and it is useful to stress again that it is clear that the Court will critically review such indications and question the debtor.

Observer or restructuring expert

9.17. If any suspicion of irregularities exist, creditors can and should bring those concerns to the debtor[135] and, if not addressed, to the Court.

9.18. Admittedly, however, it is likely difficult for a creditor who does not have access to the books and records of the company, to argue that irregularities took place. For example, the Court found objections of a creditor to the information provided regarding certain acts that may be considered detrimental, to be too speculative.[136]

9.19. If a creditor suspects the existence of irregularities but has insufficient information, that creditor may consider to request the Court (or suggest to the Court if the opportunity arises) that an observer or restructuring expert is appointed to look into these issues and improve the information they have available in assessing the plan that is proposed.

9.20. Each creditor, shareholder or a statutory works council or workplace representation instituted in the debtor's business may submit a request to appoint a restructuring expert. The debtor may also itself submit a petition to appoint a restructuring expert.[137] The request to appoint a restructuring expert should be granted if it is made *prima facie* clear that the appointment is in the interests of the joint creditors.[138]

9.21. The restructuring expert has access to the debtors administration, to the extent required to fulfil his task.[139] The debtors' directors, shareholders and employees

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134 Rb. Midden-Nederland, 8 april 2022, *JOR* 2022/261, m.nt. M.R. Schreurs, ECLI:NL:RBMNE:2022:1357.
135 Art. 383(9) DBA.
136 Rb. Limburg, 8 oktober 2021, *JOR* 2022/20, m.nt. A.J. Tekstra, ECLI:NL:RBLIM:2021:8851, *Office Depot*.
137 Art. 371 (1) DBA.
138 Art. 371 (3) DBA.
139 Art. 371 (7) DBA.

are obliged to share with the restructuring expert any information requested and should share information which they know (or should know) is relevant with the restructuring expert.[140] The restructuring expert may not share such information with third parties, unless such is required for the purposes of – in short – the WHOA proceeding.[141] The restructuring expert's fees are borne by the debtor, unless the request to appoint a restructuring expert was supported by the majority of the creditors, in which case their fees will be borne by the creditors.[142]

9.22. The appointment of a restructuring expert against the will of the debtor may be complex if the debtor qualifies as an SME. In the case of an SME, the Court will only appoint a restructuring expert if either (i) the SME debtor has filed a starting notification or (ii) the SME debtor approves the appointment of a restructuring expert.[143] Under the WHOA, a debtor qualifies as an SME if the following two criteria are met:

I. the debtor employs less than 250 employees; and
II. in the preceding financial year:
   a. the debtor's turnover was less than EUR 50 million; or
   b. the debtor's total assets did not exceed EUR 43 million.

This SME provision may lead to timing issues if the SME debtor files the starting notification late in the process.[144]

9.23. As an alternative to the appointment of a restructuring expert, the court may appoint an observer. An observer can only be appointed if no restructuring expert is appointed.[145] An observer can be appointed by the Court either on its own initiative or upon request of the debtor.[146] Other stakeholders do not (formally) have the right to request the appointment of an observer, except if

140 Art. 371 (8) DBA.
141 Art. 371 (9) DBA.
142 Art. 371 (10) DBA.
143 Art. 371(15) DBA.
144 W.J. Bartstra & A. Tavakolnia, 'De verdeling die niet kan worden aangeboden, kan ook niet tot stand komen', *TvI* 2024/33, para. 4.2.
145 Art. 380, para. 3 DBA, MvT, Kamerstukken II 2018/19, 35 249, nr. 3, p. 59.
146 Illustrative is the decision of the Court in Rechtbank Gelderland 19 oktober 2023, ECLI:NL:RBGEL:2023:7499, para. 2.13 and 2.14: 'With regard to the duties of the observer, the Court further considers as follows. The observer supervises the progress of the plan and must, in doing so, take into account the interests of the collective creditors. The observer also serves – to use a well-known expression – as 'the ears on the ground' for the court. He or she acts as an advance post for the Court, tasked with gathering information relevant to the assessment of applications, not least for the purpose of the *ex officio* assessment of a request for confirmation pursuant to Article 384(2) DBA. This entails that the Court requests the observer to submit a monthly report to the Court regarding the progress of the plan, in which he shall also comment on the realism of the timeline prepared by the applicants. Furthermore, the observer is expected to take into consideration the transparency of the plan process, which shall include, among other things,

the debtor applies for a cooling-off period,[147] although they can of course suggest such appointment if any hearings take place or filings are made prior to the request for confirmation. In the event a cross-class cram down is required for the confirmation of the plan, and a restructuring expert was not appointed, the Court has a statutory obligation to appoint an observer.[148]

9.24. In the WHOA evaluation, it was also found that the appointment of an observer often takes place too late in the process to be effective.[149] An observer must be appointed in the event that a cross-class cram down is required but in such case the stringent statutory timeframe (see para. 4.4 above) leaves little time for the observer to actually review any potential irregularities. It is argued that in such case the Court, *in lieu* of deciding on the confirmation of the plan, may stay the hearing or render an interim ruling containing additional questions.[150] In order to avoid 'rewarding' a strategy that prevents the proper performance of the observer's tasks, it seems sensible that it is made clear that if the observer is not able to carry out its tasks – cross-class cram down or not – because of time restraints and/or insufficient preparatory work by the debtor, the consequences are ultimately for the account of the debtor.

9.25. The Courts have appointed restructuring experts and observers in such circumstances on numerous occasions. In some of the earlier WHOA decisions,[151] the Court held that an investigation into irregularities in relation to the debtor would not take place in a restructuring (leading to a confirmed WHOA plan).[152] This starting point seems to have shifted somewhat over the following years. In a decision of 11 June 2021 already, an opposing creditor argued, among others, that assets were being dissipated. The Court decided to appoint an observer explicitly because the debtors provided insufficient insight in their assets and liabilities and

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an assessment of the quality, clarity, and reliability of the information provided and of the underlying data on which such information is based.'

147 Art. 376((9) DBA.

148 Art. 380 (3) DBA.

149 Verstijlen, a.w., p. 126.

150 Neijt, a.w., para. 4.3.

151 See a.o. Rb. Den Haag, 15 november 2021, *JOR* 2022/50, m.nt. R. van den Sigtenhorst, ECLI:NL:RBNNE:2021:5106, Rb. Rotterdam 7 februari 2022, ECLI:NL:RBROT:2022:12203.

152 Vgl. Van Dieren-Muller & Butot, a.w., para. 3; S. Renssen, 'De WHOA als afwikkelingsinstrument', *HERO* 2022 / P-016, para. 4, Nieuwesteeg & Peters, a.w., para. 13.5.

assets may have been dissipated.[153] In the Direct Pay matter,[154] the Court decided to appoint a restructuring expert and explicitly held that:[155]

> The indirect director of the debtor has stated that by now all the information that Rabobank requires to determine its position is available. Rabobank, the restructuring expert and, where required, the Court must be able to verify this in the short term. In addition, the reports on the reorganization and liquidation values should become available in the short term. As Rabobank rightfully argued, where the circumstances so merit, the determination of the liquidation value must include the value of any potential claim on the basis of directors' liability.

I would add, again, that any directors' liability claims may of course also impact the reorganization value.

9.26. In January 2023, the Court appointed an observer on its own initiative in order to clarify certain issues, including the current-account positions and the management fees included in the 2022 annual accounts.[156] Noticeably, only the debtor made a filing with the Court and only the debtor appeared at the hearing. It follows that the Court did critically examine the information provided to it. The observer was subsequently left unpaid by the debtor. The cooling-off period was therefore terminated and the appointment of the observer withdrawn.[157]

9.27. In a separate case, the Court decided that a restructuring expert can decide to have an investigation performed into potential irregularities so that they can assess the position of the creditors in a bankruptcy scenario.[158]

9.28. In the matter of WWTG (discussed also in Chapter 5), the observer informed the Court that the director had used funds to enter into speculative (crypto) trades which were loss-making.[159] The observer argued, and the Court agreed, that in the event of a bankruptcy the bankruptcy trustee would investigate the causes of the bankruptcy including the crypto trades. These trades may well lead to directors' liability, for which a D&O policy was in place. The Court held that the WHOA

153 Rb. Zeeland-West-Brabant 11 juni 2021, ECLI:NL:RBZWB:2021:6913.
154 The identity of the debtor was disclosed by Tekstra in his case note under Rechtbank Rotterdam 13 maart 2023, *JOR* 2023, 194.
155 Rechtbank Rotterdam 6 juli 2022, ECLI:NL:RBROT:2022:12081, para. 5.12.
156 Rb. Den Haag 23 januari 2023, ECLI:NL:RBDHA:2023:1230, para. 3.11.
157 Rb. Den Haag 9 februari 2023, ECLI:NL:RBDHA:2023:1486.
158 Rb. Midden-Nederland 9 februari 2024, ECLI:NL:RBMNE:2024:605, *JOR* 2024/148, m.nt. B.A. Schuijling.
159 Rb. Amsterdam 5 november 2022, *JOR* 2022/70.

proposal did not include any arrangement for this claim and denied an extension of the cooling-off period on this and several other grounds.

9.29. On the flipside, if the observer does not identity any irregularities, it will likely be very difficult to convince the Court otherwise.[160]

9.30. Nonetheless, in the evaluation of the WHOA that was published in 2023,[161] it was observed that it still seemed an open question whether the restructuring expert or the observer is to perform an investigation into irregularities – and to what extent. In my view, the first question should not be an open question at all.[162] The existence of irregularities is an important element in the determination of the liquidation value (and potentially the reorganization value) of the debtor and should as such be reviewed if there are indications that irregularities took place (i.e. not only in clear-cut cases of fraud or mismanagement). It is therefore correct that the 'Guidance for Observers'[163] provides:

> If the observer has any indications that irregularities took place, an investigation takes place into the question whether the interests of creditors are served by the plan, or are better safeguarded in a bankruptcy.

As is the central theme in this paper, in my view there should not be a binary choice between a bankruptcy and a simple confirmation of the WHOA plan, because a WHOA plan can be structured to allow for redressing irregularities by creating a liquidating trust.

9.31. The question to what extent an investigation is required is more difficult to answer. The calculation of the (liquidation) value and the matter of detail thereof depend on the circumstances of the case.[164] Obviously, one element is the materiality of the potential irregularities. If the value of the claims arising out of these irregularities is so limited that it does not materially impact the (voting on the) plan, it seems there is limited upside to an investigation. Conversely, if the potential value is high or the existence of irregularities impacts the distribution of value ('where the value breaks'), more thorough investigations may well be required and/or the investigations should be assigned to a liquidating trust. It is, ultimately, up to the

160 Rb. Gelderland 4 december 2023, *JOR* 2024/78, m.nt. M.S. Breeman, ECLI:NL:RBGEL:2023:7127.
161 Verstijlen, a.w., p. 55.
162 See also Neijt & Broekema, a.w.
163 https://www.rechtspraak.nl/SiteCollectionDocuments/Leidraad-Observatoren-in-procedures-op-grond-van-de-Wet-Homologatie-onderhands-akkoord.pdf.
164 A.o. Rechtbank Midden-Nederland 4 maart 2025, ECLI:NL:RBMNE:2025:932, para. 5.6.

creditors to negotiate and vote on a plan that allows for a sufficiently detailed investigation.

Conclusion

9.32. Irregularities are relevant in the determination of the liquidation value, and in many cases also the reorganization value, and as such should in principle be disclosed when a WHOA plan is proposed. Stakeholders would be well-advised to consider the information gathering options they have which do not involve the Court. To the extent the assistance of the Court is required, the judges in the WHOA pool are experienced and will scrutinize information provided by the debtor that is not conclusive. If suspicions remain, stakeholders may consider to request the Court (or suggest to the Court if the opportunity arises) that an observer or restructuring expert is appointed to look into these suspicions and improve the information they have available in assessing the plan that is proposed. Finally, as follows from the previous chapters, assigning potential claims arising out of irregularities to a liquidating trust and providing that trust with a budget to investigate will make a more thorough investigation possible while the WHOA plan can be confirmed.

10. Improvements in Ex Ante Information Provision: Related-Party Transactions

10.1. An interesting proposal is the introduction of additional obligations to provide certain information in the plan proposal (on the basis of Art. 375, para. 3 DBA).[165] By way of an example, it is stated that information about the following should be provided:[166]

- The dividend policy in the three years prior to the proposal of the plan;
- Payments to, and transactions with, related parties that took place within one year prior the proposal of the plan; and
- A statement from an auditor about the state of the books and records (in conformity with Art. 2:10 DCC).

165 Van der Berg & Schreurs, Groene Serie Privaatrecht, artikel 375, aantekening A.5: 'This Article aligns with Articles 8 and 18(5)(1) of the Restructuring Directive. These provisions stipulate that Member States must incorporate into their national legislation the requirement that a restructuring plan submitted for voting by creditors and shareholders must include at least certain specified information…. Member States are permitted to supplement the information requirements.'

166 J.A. van der Meer, 'Misbruik van de WHOA', *FIP* 2021/1.

10.2. The first two points effectively concern related-party transactions.[167] Almost by definition, related parties transactions are difficult to identify and evaluate for third parties such as the (outside) creditors of the debtor. If the related-party transactions are recent, they will not be included in the annual accounts of the debtor.

10.3. As is argued in this paper, any claims that arise out of pre-filing irregularities should be included in the determination of the liquidation (and reorganization) value that is shared with the stakeholders. Nonetheless, there are indeed strong arguments to additionally create an *explicit* obligation to provide information about related-party transactions.

10.4. The legislation and case law that deal with irregularities contain various provisions for related-party transactions, either in the form of evidentiary presumptions or by applying stricter rules. These provisions came into existence because the legislator and the courts have identified related-party transactions as an area of concern. For many professionals in the insolvency market, these concerns will be self-evident.

10.5. The Court has already dealt with cases involving related-party transactions. In one case, it appeared that the employee costs in 2021 were almost three times as high (EUR 304k) as those in 2020 (EUR 112k), which increase, according to the director, was caused by 'a review of the wage bill'. Only in response to questions from the Court, it turned out that the increase was caused by additional wages for the director himself.[168] In a second case, the Court appointed an observer on its own initiative in order to clarify certain issues, including the current-account positions and the management fees included in the 2022 annual accounts.[169] The Court will be much assisted if these findings are not dependent only on the Court being very much alert to these risks. Also, the Court should not be dependent on (outdated) annual accounts. The debtor should inform the Court about such transactions on its own initiative.

10.6. The next question is what the definition of a related-party transaction should be. The definition of what constitutes a related-party transaction and what behaviour is or is not acceptable differs between the various provisions in Dutch law (and between the various jurisdictions).

167 See also Elferink, a.w., para. 5.
168 Rb. Midden-Nederland, 8 april 2022, *JOR* 2022/261, m.nt. M.R. Schreurs, ECLI:NL:RBMNE:2022:1357.
169 Rb. Den Haag 23 januari 2023, ECLI:NL:RBDHA:2023:1230, para. 3.11.

10.7. Conceptually, one may think of a sliding scale of options to draft such related-party provisions. On one end of the scale, open definitions of related-party transactions are set, where all relevant circumstances are taken into account.

10.8. In Dutch law, such an open definition is provided in the case law dealing with selective payments in the period just prior to a bankruptcy. The current rules on selective payments created in case law are not overly clear, but what is clear is that the debtor is granted much leeway in deciding which due and payable creditors they choose to pay and which not. The noteworthy element is the exception for related-party transactions.[170] This case law refers to payments to 'group company creditors'[171] or 'creditors related to the debtor'.[172]

10.9. At the same end of the scale are the provisions in English law. Under English law, the more generic concept of a 'connected company' is used. See, for example, in relation to preferences consisting of the creation of floating charges:[173]

> Subject to the next subsection, the time at which a floating charge is created by a company is a relevant time for the purposes of this Article if the charge is created … in the case of a charge which is created in favour of <u>a person who is connected with the company</u>, at a time in the period of two years ending with the onset of insolvency,

And in relation to preferences constituting creation of fixed charges:

> (4) (…) (b) the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.
> (5) The court shall not make an order under this Article in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to produce in relation to that person the effect mentioned in subsection (4)(b).
> (6) A company which has given a preference to <u>a person connected with the company</u> (otherwise than by reason only of being its employee) at the

170 HR 12 juni 1998, *JOR* 1998/107 m.nt. Van den Ingh (*Coral/Stalt*), r.o. 3.4.3; HR 12 april 2019, *JOR* 2019/123, m.nt. Tekstra (*Ontvanger/X*).
171 HR 12 juni 1998, *JOR* 1998/107 m.nt. Van den Ingh (*Coral/Stalt*).
172 HR 12 april 2019, *JOR* 2019/123, m.nt. Tekstra (*Ontvanger/X*).
173 Insolvency Act 1986, Arts. 238, 245(3)(a) and 239(4) to (6).

> time the preference was given is presumed, unless the contrary is shown, to have been influenced in deciding to give it by such a desire as is mentioned in subsection (5).

10.10. At the other end of the scale would be provisions that provide a strict and narrow definition of a related party.

10.11. Quite far to this end of the scale is the Dutch case law dealing with the avoidance of obligatory legal acts (Chapter 8), on the basis of which avoidance of obligatory legal acts is possible if the management of the debtor and the management of the creditor was 'in the same hands'.[174]

10.12. More useful for a related-party definition in relation to WHOA proceedings is the list of presumptions that already apply to an Article 3:45 DCC avoidance action. The related-party presumptions in Article 3:46 DCC are (for debtors that are a company):

> 4°. a juridical act performed by a debtor, who is a legal person, with or towards a natural person:
> a. who is a member of the Board of Directors or of the Supervisory Board of the debtor or who is this member's spouse, child, foster child, father, mother, grandfather, grandmother, grandchild, brother or sister or the child of this member's brother or sister;
> b. who, independently or jointly with his spouse or one of the other persons mentioned above under (a), take part as a shareholder, directly or indirectly, for at least one half of the issued share capital of the debtor;
> c. whose spouse, child or foster child, father or mother, grandfather or grandmother, grandchild, brother or sister or a child of this brother or sister, independently or jointly, take part as a shareholder, directly or indirectly, for at least one half of the issued share capital of the debtor;
> 5°. a juridical act performed by a debtor, who is a legal person, with or towards another legal person:
> a. if one of these legal persons is a member of the Board of Directors of the other;
> b. if a member of the Board of Directors of one of these legal persons, which member is a natural person, is also a member of the Board of Directors of the other legal person or if this member's spouse, child, foster child, father, mother, grandfather, grandmother, grandchild, brother or sister or the child

174 HR 7 maart 2003, *NJ* 2003/429 (*Cikam v. Siemon q.q.*).

of this member's brother or sister is a member of the Board of Directors of the other legal person;
c. if a natural person, who is a member of the Board of Directors or of the Supervisory Board of one of these legal persons, or if this member's spouse, child, foster child, father, mother, grandfather, grandmother, grandchild, brother or sister or a child of this brother or sister, independently or jointly, take part as a shareholder, directly or indirectly, for at least one half of the issued share capital of the other legal person;
d. if the same legal person, or the same natural person, whether with or without his spouse, child, foster child, father, mother, grandfather, grandmother, grandchild, brother or sister or a child of his brother or sister, take part as a shareholder, directly or indirectly, for at least one half of the issued share capital of both legal persons;
6°. a juridical act performed by a debtor, who is a legal person, with or towards another legal person who is legally connected with the same group of companies as the debtor himself.

10.13. In the same vein, an insider of a corporation is defined in Article 101(31) of the US Bankruptcy Code by a non-exclusive list of eight relationships with the debtor:

- A director;
- An officer;
- A 'person in control of the debtor';
- A partnership in which the debtor is a general partner;
- A relative general partner, director, officer or person in control of the debtor;
- An 'affiliate of the debtor', which in turn is defined to include any entity that 'directly or indirectly owns, controls or holds with power to vote, 20% or more of the outstanding voting securities of the debtor';
- An insider of an affiliate as if such affiliate were the debtor; and
- A managing agent of the debtor.

Anyone who fits within this list is a statutory insider. The US Bankruptcy Code's insider definition is not exclusive. The courts have held that insiders also include any person or entity whose relationship with the debtor is sufficiently close so as to subject the relationship to careful scrutiny. This type of insider is referred to as a non-statutory insider.[175]

175 https://www.proskauer.com/pub/what-being-an-insider-means-in-ch-11-and-why-it-matters.

10.14. A creditor that is considered an insider must take into account, among others,[176] additional risks of preference and fraudulent transfer.[177]

Conclusion

10.15. Related-party transactions are always defined very broadly. It could be left completely to the Courts to interpret these broad provisions. However, a non-exclusive list of 'statutory insiders' (US Bankruptcy Code) or presumed detrimental acts (Art. 3:46 DCC) may also be provided.

10.16. From the viewpoint of the obligation of the debtor to provide the stakeholders with the information required for their decision-making, a list of parties that qualify as a related party is much preferred.

11. Liability for Wilfully Sharing Incorrect Information in the WHOA?

11.1. It will not always be possible to fully address all pre-filing irregularities from an ex ante perspective. Of course, creditors and their advisers should be well aware of the potential existence of irregularities and question the debtor where appropriate. The debtor is obligated to include the value of claims arising out of irregularities in the liquidation value (and reorganization value) presented to creditors. If doubts remain, they can request the Court to appoint a restructuring expert or suggest an observer to investigate further. In addition, it would be helpful if a specific obligation is imposed to share information about related-party transactions (however defined). If required, further investigations can be made by a liquidating trustee. Ultimately, of course, this will not be airtight and it may occur that irregularities only come to light post-confirmation of the WHOA plan.

176 There are also consequences for plan voting. Confirmation of a Chapter 11 plan requires, among other things, the acceptance of at least one impaired class of creditors. For purposes of determining whether an impaired class has accepted the plan, Art. 1129(a)(10) of the Bankruptcy Code provides that insider votes are disregarded. This means that if a lender is an insider, its vote will be disregarded for determining compliance with Article 1129(a)(10).

177 https://www.proskauer.com/pub/what-being-an-insider-means-in-ch-11-and-why-it-matters.

11.2. It is argued that the WHOA can be easily used to cover up illegitimate behaviour, among others by providing insufficient, misleading or simply incorrect information.[178] I am not so sure this is true, given (i) the critical review by the Court (comprised of expert judges), (ii) the information shared with the Court by creditors and (iii) the option of appointing an observer or restructuring expert.

11.3. Nonetheless, a confirmed plan is binding on the debtor and on all stakeholders who were eligible to vote.[179] Recission of a confirmed plan can be excluded[180] – and it generally is. There is no possibility of appeal against the confirmation decision.[181] Having a confirmed plan declared void, to the extent even possible, is generally not a suitable way to address defects in the plan.[182]

11.4. But what has not been taken onboard yet are the *ex post* consequences for directors of a having a plan confirmed while the directors knew that irregularities took place and knowingly withheld this information from the stakeholders and the Court in a WHOA proceeding. It seems these directors may be taking material risks in terms of personal liability.

11.5. Dutch law on directors' liability towards third parties (i.e. the disadvantaged stakeholders) is based on tort and, as a result, very subtle and highly fact dependent. A full examination of the potential for *ex post* directors' liability for providing inaccurate or misleading information in WHOA proceedings is a topic large enough for a separate paper.[183] For the purpose of this paper therefore only two separate ideas regarding liability of directors towards creditors for inaccurate or misleading information will be discussed. These are (i) introducing a tailor-made provision and (ii) liability for interim financial information.

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178 B.J. Tideman, 'Is het wetsvoorstel inzake het dwangakkoord buiten faillissement misbruikbestendig?' *NTBR* 2015/22.

179 Art. 383 DBA.

180 Art. 387(2) DBA.

181 Art. 396(10) DBA.

182 Mennens, a.w., para. 10.7.

183 For example, the analysis of the Advocat-General in the Genmed case (ECLI:NL:PHR:2022:541) is interesting. The case concerns 'brochures' which were shared by the company for the purpose of issuing bonds. The District Court and the Court of Appeals found that the brochures contained incorrect and/or misleading information and that the director was personally liable towards the bondholders. The Court applied the criterion for prospectus liability that the director knew or should have known that the incorrect and/or incomplete information in the brochures would lead to a misleading representation of affairs and that he could foresee that bondholders would suffer a disadvantage as a result. The High Court rejected the appeal without motivation.

<u>(i) Tailor made WHOA provision?</u>

11.6. There is currently a proposal pending for an amendment to the DBA providing a statutory basis for a pre-pack procedure (*Wet Continuïteit Ondernemingen I*, **WCO I**). That proposal includes a specific ground for directors' liability in the event incorrect information is provided regarding the added value of the requested pre-pack procedure. In the proposal, a paragraph is added to Article 2:248 DCC in which it is provided that if it is established that the (de facto) director of the debtor in the petition for a pre-pack procedure wilfully included incorrect information about the added value of the pre-pack procedure with a view to use the pre-pack procedure with improper motives, the director has performed its tasks improperly, with the presumption that this mismanagement was an important cause of the bankruptcy. Should the director not succeed in rebutting this presumption, they may be held liable for the entire deficit in the bankruptcy estate.

11.7. Leaving aside the details of this proposed provision, the main point here is that in the proposed pre-pack legislation there is an explicit and severe sanction in terms of personal liability for director of the debtor for sharing 'wilfully sharing incorrect information about the added value'. Comparable information should of course be shared in WHOA proceedings. There is no principal reason why personal liability for wilfully sharing incorrect information should be assumed in a pre-pack and not in the context of WHOA proceedings.

<u>(ii) Article 2:249 DCC – interim figures</u>

11.8. Secondly, there is some interesting recent (lower) case law based on Article 2:249 DCC. The number of decisions in which Article 2:249 DCC plays a role has increased since 2010.[184]

11.9. Article 2:249 DCC provides a ground for liability of directors for misleading financial statements. Article 2:249 DCC reads as follows:

> If the financial condition of the company has been misrepresented in the annual accounts <u>or in the interim figures</u> as published by the company or in the annual report, then the directors are jointly and severally liable

184 Van Bekkum, 'Civielrechtelijke aansprakelijkheid van bestuurders en commissarissen vanwege de jaarrekening', in: J.B.S. Hijink e.a. (red.), *Handboek Jaarrekeningenrecht* (Serie Van der Heijden Instituut nr. 164), Deventer: Wolters Kluwer 2020, para. 48.2.2.1.

towards third persons for the damage which they have suffered as a result thereof. A director who proves that such misrepresentation is not attributable to him, is not liable.

11.10. A central question is when financial statements qualify as interim figures. The District Court of Amsterdam found that interim financial information ('actuals') provided to a bank for the purpose of obtaining a loan qualifies as interim figures in the sense of Article 2:249 DCC.[185] The court considered that it followed from legislative preparatory works that the term 'interim figures' was added to Article 2:249 DCC because the legislator was aware of the growing practice that interim figures were provided to third parties and the legislator intended to protect third parties that are provided with such interim figures, if misleading, by introducing a directors' liability regime. A third party who takes cognizance of interim figures should be able to trust that the board is prudent to such an extent that the figures do not provide a knowingly skewed representation of the financial position of the company. The court leaves undecided whether the forecasts provided to the bank also qualify as interim figures.[186] Nonetheless, it is noteworthy that although the information shared contained both actuals and forecasts, the court reviewed the actuals on their own merits and qualified these as misleading interim figures.

11.11. Along the same lines, the district court of Noord-Holland found that financial information shared in the context of negotiations on an M&A contract qualifies as interim figures in the sense of Article 2:249 DCC[187] and found the directors of the seller liable.

11.12. Another court found that a trial balance shared between the parties in that case should be considered 'work in progress' as part of the internal books and records and therefore the trial balance did <u>not</u> qualify as interim figures in the sense of Article 2:249 DCC.[188] In the case note under this decision, the author argues that the intentions of the directors sharing the document are important in determining whether the information shared qualifies as interim figures. I understand the argument to be that financial information shared in a formal setting is more easily qualified as interim figures (as a result of which Art. 2:249 DCC applies) than information shared in the heat of the moment.

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185 Rb. Amsterdam 8 december 2021, ECLI:NL:RBAMS:2021:7044.
186 Para. 4.12.6.
187 Rb. Noord-Holland 11 april 2018, ECLI:NL:RBNHO:2018:2942, para. 4.62 e.v.
188 Hof 's-Hertogenbosch 2 augustus 2011, *JOR* 2012/72, m.nt. Bras.

11.13. If both (i) the intentions of the board for sharing the information and (ii) the formality if the setting in which the interim figures are shared are determinative for the application of Article 2:249 DCC, there are strong arguments that Article 2:249 DCC should apply to information shared in the context of a WHOA proceeding. If so, this may serve as a severe sanction on sharing misleading information in a WHOA plan and/or during WHOA proceedings.