Telecom Sector Brings U.S. Chapter 11 Closer to the Netherlands

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The telecom sector is full of distressed companies. For most of them here in Europe, they seem to be financed in the same way. In Holland, typically there will be a Dutch subsidiary that will have issued bonds for millions of euros and that holds shares in several European subsidiaries. At the sub-sub-level, there will be traditional bank financing.

A buyer interested in acquiring the parts of a business that has run out of working capital will negotiate with the bondholders because the company will usually lack major common creditors. On the continent, the U.S. approach of negotiating with the bondholders to reach a "deal" is increasingly being adopted.

This happened in late 2001 when KPNQwest acquired the Ebone broadband network and the central European businesses of Global Telesystems Europe BV, a sub-subsidiary of Global TeleSystems Inc. of Delaware. The primary negotiations were with the company's creditors, not the equity-holders, and a pre-negotiated bankruptcy was the preferred route. The parties agreed that GTS Europe, probably to avoid the applicability of Dutch laws against trading while insolvent, would file in the Netherlands for a suspension of payments proceedings ("surseance van betaling"), while GTS Inc. would file for bankruptcy in Delaware.[1] Given the rather formal requirements in the Dutch Bankruptcy Act, it was agreed that the U.S. court would set the tone.

There was some uncertainty as to whether the Dutch court in Amsterdam would be receptive to mirroring the proceedings of the bankruptcy court in Delaware (which applied the chapter 11 procedure to both). In the United States, the reorganization plan and related statements were filed, and the coordination process then really came to life.

The Bankruptcy Law Systems Differ

GTS Europe BV had raised capital through five bond issues, which were held by clearing organizations like DTC, Euroclear and Clearstream. Bondholders did not have bearer notes. The bonds were subject to five indentures that were governed by New York law. In the U.S. proceedings, the proposed plan (which, among other things, provided for a conversion of GTS Europe bonds into convertible KPNQwest bonds) was approved by 99.36 percent of the creditors, representing 98.35 percent of all claims.

There were some difficulties in aligning this process with the Dutch system. In the Netherlands, broad U.S.-style classes of creditors are unknown, the concept of beneficial ownership is not recognized, and the voting procedures differ quite considerably. In a typical suspension of

payments proceeding in the Netherlands, the court convenes a meeting of the creditors in order to vote on the reorganization plan. Creditors' claims are put on a provisional list containing the names and addresses of the creditors and the nature and the amount of their claims. A plan requires acceptance by two-thirds of the unsecured claims present at the meeting and three-quarters of the value of the claims represented at the meeting. There is an exception for bearer bonds. On the provisional list of creditors, every verified bearer claim is treated as a claim from a separate creditor. And to add some flavor: The exception provision dates back to 1896 and has never been changed!

In today's financial world, bearer bonds have become scarce. The technique is that a "common depository" will hold the bonds, and the ultimate owners are registered in the system. Where, quite commonly, the bonds are subject to New York law, conventional Dutch insolvency law concepts have to be addressed. Who is the "creditor": the 'unspecified' individual or the trustee? Who may vote if the trustee had not been given that right? If the bearer bond exception does not apply, how do you find out who the ultimate owners are? In U.S. practice, as I understand it, the voting materials are circulated by the common depositary and ultimately reach the beneficial owners, who then vote and send their ballots back through the system. This means that the bearer bondholders do not (physically or by power of attorney) meet and vote during the meeting of creditors. Their voting is done prior to the meeting. Since December 1999, the Netherlands has had provisions for proxy voting at shareholders meetings, but these changes have not made their way into the provisions for creditors' meetings in the Bankruptcy Act.

Coordination by Practical Reality

In the plan process, the Amsterdam court (Feb. 22, 2002)[2] was faced with a complex request that had never before been addressed in the Netherlands. The parties needed to receive an answer prior to the meeting of the creditors, as huge financial interests were at stake and time was critical. The court, in summary, decided that:

1. The bearer bond exclusion provision could be applied by analogy. Although the bondholders did not possess bearer notes, they had a similar position: "It would be contrary to economic reality to earmark the legal owner as the only creditor instead of the real interested parties, the beneficial owners."
2. It was not necessary to name the creditors who participated in the voting on the reorganization plan.
3. The voting procedure, as developed in the U.S. chapter 11 proceedings, could be recognized in the Dutch voting process.

The court specifically found that the U.S. proceedings were sufficient. Beneficial owners were able to submit their votes, the judge decided on a specific record date, and an independent ballot agent took care of the counting of votes. The ballots therefore counted as votes by the beneficial owners during the meeting: "By applying these votes as votes presented during the meeting of the creditors, the court is, in the given circumstances, of the opinion that it best protects the rationale of the suspension of payments proceedings."

Conclusion

Interested parties and the insolvency community have generally applauded this approach. It is very practical and does not unnecessarily interfere with global business. *Journal* readers have seen several approaches that are designed to bring together different legal systems and improve cross-border reorganizations. In this case, an individual court with an open mind for economic reality achieved this result. Nevertheless, especially in the code-based jurisdictions of Western Europe, legislation is a solid foundation of the legal system that cannot be set aside easily. One robin does not make a summer. In this specific case, elements such as the global nature of the business, the type of finance and the age of the specific provision that had to be interpreted were in favor of the outcome. The matter is still under review by the Dutch Supreme Court.

Footnotes

[1] To make use of U.S. Bankruptcy Code §1145, which provides for a broad exemption for the company's solicitation of votes on, and the issuance of securities under, the plan. Return to article

[2] The general rule is that a supervisory judge in bankruptcy cases makes the ruling. In this case, he took the position (which flows from the Dutch Act) that he could only give his judgment after the meeting of the creditors, which of course was very uncertain. The court based its decision on a specific provision allowing it to take any measure necessary to protect the interests of creditors. This criterion has not been explained in the Parliamentary documents, but the provision should be seen as a last resort to ensure that the objectives of the suspension of payments proceedings are achieved. It could result in a solution that does not fully fit into the framework of the Bankruptcy Act. A historic example is the decision of the Amsterdam court (Nov. 4, 1966) that appointed—in suspension of payments proceedings by a bank—a creditors' committee, although creditors' committees are only available in bankruptcy proceedings and during postponement proceedings when there are more than 5,000 creditors. In the 1966 case, there were 1,000 creditors with around 45 million euros (roughly the same in U.S.$) in claims. The *GTS* case will be a mouse with a long tail. The supervisory judge in the *GTS* case has filed *ex officio* for the specific procedure of "cassation in the interest of the law" to have the Dutch Supreme Court's decision on this alleged lack of competence of the court. Return to article

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