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Jonkers, A.

Publication date
2019

Document Version
Final published version

Published in
The 800-Pound Gorilla

Selective Perforation by Means of Guarantees: Dutch Law

Aart Jonkers[*]

"The 800-pound gorilla in the corner that goes unnoticed"[1]

1 Introduction

By means of limited liability and separate legal personality, groups can incorporate in ways where liabilities and assets are allocated to different legal entities. After division into subsidiaries, the first step is often to selectively perforate the newly created limited liability structure in favor of financial creditors.[2] The question could be asked whether, in such a selectively pierced group structure, the separateness of the legal entities the group consists of can still be taken seriously. This question and the approach of Dutch law to this question are briefly discussed in Section 2. A bankruptcy administrator could, in theory, attack the guarantee itself with transaction avoidance law, but Dutch law is underdeveloped on this point, as discussed in Section 3.

Counterintuitively, in practice the legal rules applicable to group guarantees seem very friendly to financial creditors. Dutch law, for example, often provides that guaranteed creditors can claim up to the full amount in the different insolvency proceedings when various group companies are declared insolvent. This issue is discussed in Section 4.

Moreover, such guarantees give an incentive to the group companies to make selective payments to the guaranteed creditor, as such payments indirectly benefit the possibly surviving group companies. In case of distress of certain group companies, this incentive becomes stronger. In that sense, intergroup guarantees can be seen as promises to the lender to make preferential payments, especially on the eve of bankruptcy. This dynamic has been almost completely overlooked in Dutch law and literature. These points are discussed in Section 5.

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* Aart Jonkers is a teacher and researcher at the Centre for the Study of European Contract Law, University of Amsterdam.

1 Derived from a quote by Widen: " (…) if secured lending presents fairness problems, the unsecured syndicated guarantee may be the 800-pound gorilla in the corner that goes unnoticed."; W. Widen, "Corporate Form and Substantive Consolidation," *The George Washington Law Review*, Vol. 75, No. 2, 2007, p. 309.

2 R. Squire, "Strategic Liability in the Corporate Group," *The University of Chicago Law Review*, Vol. 78, 2011, p. 606.

2 Dutch Law on Veil Piercing in Relation to Selectively Pierced Group Structures

The international literature has recognized that the arguments justifying limited liability of a legal entity are much less strong within a corporate group[3] and again less strong when those group entities have selectively pierced their limited liability shield by guarantees to major creditors.[4] How does Dutch law deal with these insights? One would expect the law to sooner allow for veil piercing when group entities have pierced the group structure with guarantees, but there is little evidence that this is the case under Dutch law.

Both in public and private companies, shareholders of the company are not personally liable for the (unpaid) debts of the corporation (Art. 2:64 paragraph 1 BW and 2:175 paragraph 1 BW, respectively). However, in case of abuse of legal personality, a court could equate the legal person with its shareholder(s), thus burdening the shareholder with all the debts of the legal person, effectively canceling legal personality and thus limited liability. Dutch courts hardly ever do so.[5] Necessary conditions for such equation probably include a clear case of abuse of legal personality with the purpose of avoiding opportunities for recovery by creditors.[6] Next to direct veil piercing, creditors and/or the bankruptcy administrator could pursue shareholders on the basis of tort (Art. 6:162 BW), often referred to as indirect veil piercing. If such a claim succeeds, the boundaries between the shareholder and the company it holds shares in are not completely disregarded, but the shareholder is de facto held liable for some specific debt(s) of the company. The question is whether shareholders can generally be more easily held liable because they have already voluntarily pierced the veil by giving one creditor a guarantee.

Relevant in this context is that, next to liability for distributions, the Dutch Supreme Court has also set out the conditions for holding shareholders responsible for (certain) debts of the subsidiary on the basis of Article 6:162 BW (tort law) in situations of un-

3 A.A. Berle, "The Theory of Enterprise Entity," *Columbia Law Review,* Vol. 47, No. 6, 1947, pp. 343-358; F.H. Easterbrook & D.R. Fischel, "Limited Liability and the Corporation," *The University of Chicago Law Review*, Vol. 52, No. 1, 1985, pp. 110-111; H. Hansmann & R. Squire, "External and Internal Asset Partitioning: Corporations and Their Subsidiaries," *in* J.N. Gordon & W.G. Ringe, *The Oxford Handbook of Corporate Law and Governance*, Oxford University Press, 2016, para. 3; P.I. Blumberg, "Limited Liability and Corporate Groups," *The Journal of Corporation Law*, 1986, pp. 623-626; T.K. Cheng, "An Economic Analysis of Limited Shareholder Liability in Contractual Claims," *Berkeley Business Law Journal*, Vol. 11, No. 1, 2014, pp. 112-181; G.C. Rapp, "Preserving LLC Veil Piercing: A Response to Bainbridge," *The Journal of Corporation Law,* 2006, p. 1094; K. Vanderkerckhove, *Piercing the Corporate Veil*, Alphen aan den Rijn, Kluwer Law International, 2007, p. 9.

4 Hansmann & Squire, 2016, para. 3.

5 Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II*, *De naamloze en besloten vennootschap*, Deventer, Kluwer, 2009, nr. 836.

6 *See* J. Barneveld, *Financiering en Vermogensonttrekking door Aandeelhouders,* Deventer, Kluwer, 2014, pp. 470-471; The Dutch Supreme Court case Krijger/Citco (June 9, 1995, *NJ* 1996, 213) is also often mentioned in this context, although the case is strictly not about veil piercing, *see also* L. Groenewoud, "Vereenzelviging als grond tot doorbraak van aansprakelijkheid," *Vennootschap & Onderneming*, No. 1, 2003, pp. 4-5.

justifiably continuing the company.[7] In short, a parent company (or shareholder) can be held liable if there are close ties between shareholder and company with the accompanying power of intervention of the shareholder,[8] which leads to the conclusion that the parent has some duty of care toward creditors of the subsidiary, while this duty has been breached at a certain point by not acting on a moment that the subsidiary is in a deplorable financial state and the shareholder knows, or should have known, that new creditors would be prejudiced.[9] This category of shareholder liability is often referred to as liability for creating an appearance of creditworthiness. The parent company can be held liable for the claims of creditors on their subsidiary if these claims came into existence after the moment that the parent should have acted. Whereas the earlier case law of the Dutch Supreme Court led many to believe that liability could occur only if this appearance of creditworthiness was created actively,[10] for example by the shareholder communicating to creditors that he would continue to financially support their debtor,[11] later case law seems to allow for the possibility of claiming on the parent even if the parent did not actively create the appearance.[12]

It is important to note that the mere fact that the parent has financed the subsidiary, directly with loans or indirectly with guarantees, and stops this financing at some point, can in itself probably not lead to the conclusion that the parent can be held liable for creating an appearance of creditworthiness.[13] A shareholder that still invests in the company prior to insolvency, and thus takes risk himself, is often actually less likely to be held liable for creating an appearance of creditworthiness.[14] In that sense, the fact that a shareholder guarantees or has guaranteed certain debts of the company could, counterintuitively, make it more likely that the shareholder escapes liability toward other creditors.

There are also some cases in which liability of shareholders was not based on not acting by the shareholders at a moment at which bankruptcy of the debtor was foreseeable, but as such on the dubious corporate structure of which the bankrupt debtor was

7 Most notable are: Dutch Supreme Court September 25, 1981, *NJ 1982, 443* (Osby); Dutch Supreme Court September 12, 2008, *JOR* 2008/297 (Van Dusseldorp/Coutts Holding); Dutch Supreme Court February 19, 1988, *NJ* 1988, 487 (Albada Jelgersma); Dutch Supreme Court November 18, 1994, *NJ* 1995, 170 (NBM/Securicor); Dutch Supreme Court December 21, 2001, *JOR* 2002/38 (Sobi/Hurks).

8 *See* particularly Dutch Supreme Court December 21, 2001, *JOR* 2002/38 (Sobi/Hurks) and the case note by Bartman; *see also* Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II*, 2009, nr. 842.

9 Dutch Supreme Court December 21, 2001, *JOR* 2002/38 (Sobi/Hurks).

10 *See* case note Bartman to Dutch Supreme Court December 21, 2001, *JOR* 2002/38 (Sobi/Hurks).

11 *See* for such a case Dutch Supreme Court February 19, 1988, *NJ* 1988, 487 (Albada Jelgersma).

12 Dutch Supreme Court December 21, 2001, *JOR* 2002/38 (Sobi/Hurks); *see also* Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II*, 2009, nr. 842.

13 *See* the Court of Appeal case that led to Dutch Supreme Court September 12, 2008, *JOR* 2008/297 (Van Dusseldorp q.q./Coutts Holding).

14 *See* para. 4.20 of the Advocate General's opinion to Dutch Supreme Court September 12, 2008, *JOR* 2008/297 (Van Dusseldorp q.q./Coutts Holding).

part. Such cases are, however, rare. The leading case before the Dutch Supreme Court is Comsys.[15] This case has been extensively discussed in the first part of this report on Dutch law, by Verstijlen & Karapatian. The relevance of this type of liability to selectively pierced group structures is that operating a group such as the one in the *Comsys* case is often essentially made possible by piercing guarantees. Strangely enough, this is not as such discussed in the *Comsys* case itself, although piercing guarantees were very likely in place. The Court of Appeal does mention that there was one credit contract between the whole Comsys group and Rabobank and that Comsys Services had pledged all its assets to Rabobank. These circumstances are almost unthinkable without each group member guaranteeing the whole debt. Because of these guarantees, Rabobank did not have to care much about the internal group structure. The parent profits from the structure, the major lender that makes the structure possible by financing does not care about the structure because all group companies have issued guarantees to the bank, and the creditors that probably had no knowledge of the structure are prejudiced. The guarantees are a crucial part of making the structure practically possible.

In short, Dutch law does not clearly consider the guarantee by a shareholder a relevant factor in shareholder liability cases. In that sense, Dutch law pays little attention to the opaque priority structure that the guarantee and incorporation together can create.

3 Avoiding the Guarantee Itself

An alternative legal response to tearing down the limited liability walls in order to address the inefficiencies of certain perforated limited liability structures is to reinstate the walls by giving certain actors such as other creditors or the bankruptcy administrator the power to annul the guarantee. Under Dutch law, an avoidance action (a*ctio pauliana*) seems most suitable to this end, though it will often be difficult to apply. Other instruments to avoid (the effects of) a piercing guarantee that may come to mind are an action based on the doctrine of *ultra vires* (*doeloverschrijding*) and an action based on conflict of interest of the directors involved. Both these actions are, however, excessively hard to apply to the situation discussed. These actions thus need little further discussion.

Under Dutch law, the bankruptcy administrator can avoid certain acts that the debtor performed before bankruptcy, the so-called actio pauliana. Within transaction avoidance law, the Dutch doctrine distinguishes between legal acts that the debtor was obliged to perform (Art. 42 Fw) and acts that were not required by a preexisting legal duty (Art. 47 Fw). Acts that were required by a preexisting legal duty are generally (much) more difficult to avoid for a bankruptcy administrator. If a group entity guarantees group debt toward a lender, this may be on request of the parent or holding company. Such an

15 Dutch Supreme Court September 11, 2009, NJ 2009/565 (Comsys/Van den End q.q.) with case note by H.J. Snijders and P. van Schilfgaarde.

instruction by the parent does, however, not make issuing the guarantee "obliged" in the sense of Article 47 Fw. Only legal obligations toward the counterparty of the contested act qualify as obligations in the sense of Article 47 Fw.[16] Unless the debtor committed himself toward the creditor to issue the guarantee prior to guaranteeing, the bankruptcy administrator can rely on Article 42 Fw in trying to avoid the act.

For the application of Article 42 Fw, the bankruptcy administrator should, next to showing that there was no legal duty to perform the act, show the act brought prejudice to the creditors and that both the debtor and the counterparty had knowledge of such prejudice (Art. 42 Fw). Knowledge of prejudice on the part of the counterparty does not have to be shown by the bankruptcy administrator in the case that the act was for no consideration, and if such act for no consideration was performed within less than one year prior to insolvency, knowledge of prejudice is presumed to exist on the part of the debtor (Art. 45 Fw). These exceptions may apply to issuing guarantees in the context of group finance if it can be shown that the debtor in no way profited from issuing the guarantee. In the case *X q.q./Van Doorn Beheer*, the Court of Appeal found that a guarantee of an ex-subsidiary, that guaranteed the debt of the buyer of the shares of that subsidiary toward the ex-parent company, was an act without consideration.[17] More generally, however, the courts are likely to assume that indirect benefits from the guarantee will qualify as consideration.[18] Most guarantees for group debt, or guarantees by natural persons for debts of a limited liability corporation in which they hold shares, will thus probably qualify as acts for consideration.

Secondly, prejudice to creditors needs to be shown. The Dutch Supreme Court has a rather broad understanding of prejudice, which makes proving prejudice generally no issue for the bankruptcy administrator.[19] Showing (somewhat objectified) *knowledge* of prejudice is generally, however, hard, especially on the side of the counterparty. The yardstick that the Supreme Court has formulated is that such knowledge exists on the side of the counterparty if it can be shown that bankruptcy and a deficit in such bankruptcy, which implies prejudice to creditors, could have been forecast with reasonable probability.[20] This is generally hard to show.

The bankruptcy administrator is, however, helped with the evidentiary presumptions of knowledge of prejudice (on both the side of the creditor and that of the debtor) of

16 P. van Schilfgaarde, "Aantasting van concernfinanciering door de actio pauliana en de actie uit onrechtmatige daad," *in* Honee, Lievens & Van der Grinten, *Financële kruisverbanden en andere aspecten van concernfinanciering*, Deventer, Kluwer, 1987, p. 86; compare also District Court of The Hague (president) June 23, 1992, KG 1992/343. *See* on that case also M.Ph van Sint Truiden, "Intra-groep-garanties en de (actio) pauliana," *Bedrijfsjuridische Berichten*, No. 25, 1992, pp. 223-225.

17 Arnhem-Leeuwarden Court of Appeal, February 12, 2013, ECLI:NL:GHARL:2013:822, *JOR* 2013/78.

18 Dutch Supreme Court July 13, 2012, JOR 2012/306 (Janssen q.q./JVS).

19 Dutch Supreme Court October 19, 2001, ECLI:NL:HR:2001:ZC3654, NJ 2001, 654 (Diepstraten/Gilhuis q.q.); Dutch Supreme Court July 8, 2005, NJ 2005, 457, JOR 2005/230 (Van Dooren q.q./ABN AMRO II).

20 Dutch Supreme Court December 22, 2009, ECLI:NL:HR:2009:BI8493, *NJ* 2010, 273 (Van Dooren q.q. / ABN AMRO III).

Article 43 Fw, which presumptions may apply to the case of guarantees in the context of group finance and guarantees by business owners. The first requirement for the presumption to apply is that the guarantee was issued within one year prior to insolvency. For older guarantees, the bankruptcy administrator will always have to show that bankruptcy and a deficit in such bankruptcy could have been forecast with reasonable probability by both parties to the transaction.

If the guarantee was issued in the year prior to bankruptcy, the presumption applies only if one of the following alternative conditions is also met: (1) the transaction was at an undervalue; (2) the transaction was a payment on or security for old debt that was not yet due; (3) the counterparty was a related party, as defined in Article 43 paragraph 1 (3)(4)(5) and paragraphs 2-6. The background of these requirements is that Article 43 Fw describes particularly suspect categories of transactions that should more easily be up for avoidance.

The first alternative condition, transactions at undervalue, is complicated to apply to guarantees. As discussed earlier, even guarantees for which no direct premium is paid will usually be viewed as "for consideration." That does not mean that the up- and downside to the guarantor were sufficiently balanced. If, in the group context, the debtor that issued the guarantee hardly used the credit facility, this may lead to the conclusion that, while there may have been consideration, the transaction was performed at an undervalue.[21] If the transaction was at an undervalue because the profit the debtor had from the transaction was disproportional to the liability incurred, the creditor could possibly argue that he did not have to have insight into the internal relations of his debtors.[22] Whether this suffices is unsure and probably dependent on the circumstances. As Van Schilfgaarde argues, this defense becomes difficult to maintain if the liability of the debtor under the guarantee exceeds the size of the patrimony of the debtor.[23] The focus in applying this requirement is on what the upside was for the guarantor and what liability was incurred, and to what extent these are in balance. As shown by Squire, this focus does not track the efficiency analysis of such guarantees.[24] The focus should be on the question of the extent to which the fate of the guarantor and that of the debtor were correlated. The more they were correlated, the more likely that the guarantee defrauded other creditors.

The presumption also applies if the guarantee was assumed for an older debt that was not yet due (Art. 43 paragraph 1 sub 2).[25] Guarantees are probably often granted for such old debts that are not yet due, but, by definition, not debts of the debtor himself but debts of others. The requirements thus do not apply directly. One could convincingly argue for analogous application, but there is no leading case law on this point.

21 *See also* Van Schilfgaarde, 1987, pp. 86-87.
22 Van Schilfgaarde, 1987, p. 87.
23 Van Schilfgaarde, 1987, p. 87.
24 Squire, 2011.
25 If the guarantee was given for a new debt, this presumption does not apply; *see* Dutch Supreme Court November 29, 2013, *NJ* 2014/9 (Roeffen q.q./Jaya).

The same applies to the alternative condition of related party transactions in Article 43 paragraph 1 (3)(4)(5) and paragraphs 2-6. These apply in the case that the counterparty is such a related party of the debtor. Where the debtor guarantees group debt or debts of a legal person he holds shares in, the counterparty is often not a related party, whereas the principal debtor obviously is. Again, the presumption of Article 43 thus does not apply directly to acts in the year before bankruptcy. Analog application is somewhat harder to argue here, as the act is avoided by a successful action that comes directly to the detriment of the unrelated creditor.

In short, reinstating the walls by avoiding guarantees is difficult under Dutch law. Guarantees that have been granted longer than a year before bankruptcy are very hard to avoid, as knowledge of prejudice to creditors on both sides (interpreted as reasonably have been able to foresee bankruptcy) will have to be shown. In the year before bankruptcy, an evidentiary presumption as to this requirement may apply, but this is not obvious and is likely to be controversial. All this is only the case if the guarantee was voluntarily granted. If there was a legal obligation for the debtor to issue the guarantee, for example on the basis of earlier contracts, the guarantee is even harder to avoid.

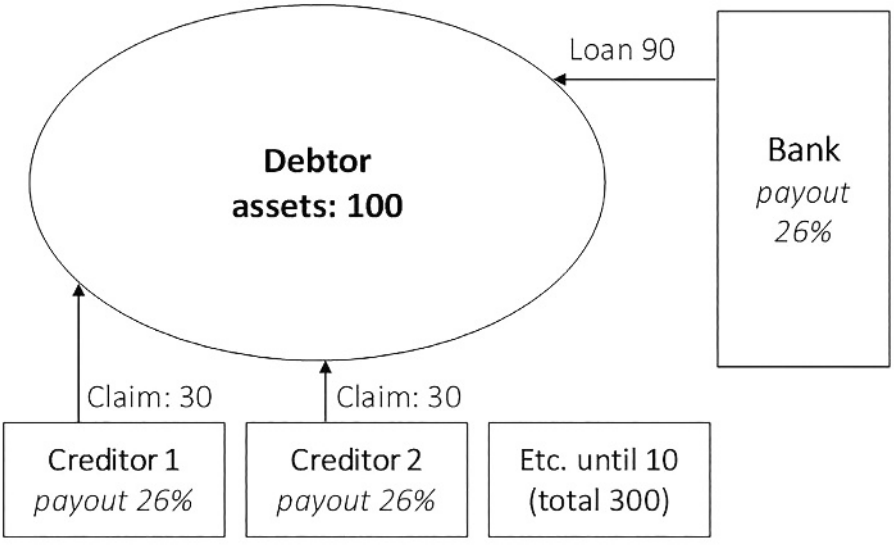
4 Dutch Law on Double Proof[26]

Double proof occurs when a creditor is able to make more than one claim in relation to a single debt. This mechanism can, depending on the legal rules, occur in different degrees of strength. The following example will explain this:

Consider a bank that has an unsecured claim of 90. There are 10 other unsecured creditors, each with a claim of 10. The debtor has assets worth 100. In the case of distribution in insolvency, each would receive 26% (see figure 1).

26 This section is partly based on my article in a Dutch law journal: A.L. Jonkers, "Persoonlijke zekerheden bij concernfinanciering: ongerechtvaardigde vermenigvuldiging van vorderingen," *Maandblad voor Vermogensrecht*, No. 5, 2018, pp. 164-171.

Figure 1 Simple case without guarantees



As a variation, consider that the debtor is not one single entity but is subdivided into a holding company and 9 subsidiary entities, each with limited liability. Everything else stays the same, though the bank has provided the loan to the holding company with guarantees of all subsidiaries for the full sum, as is common in group finance. All other creditors only have a claim in relation to one single debtor, and each on a different subsidiary. If, in a bankruptcy of all the group entities, the bank were allowed to submit its claim of 90 in each bankruptcy proceeding, a strong form of double (or actually 10-fold) proof would occur. The bank is able to make ten claims of 90, thus total 900, while it has only made a loan of 90. The payout of the bank rises to 83%, while the other creditors are left with 8.3% each (see figure 2).[27] Because of this squeeze-down effect on unsecured creditors of double proof through guarantees, W. Widen has, rightly, referred to inter-company guarantees as "the 800-pound gorilla in the room that goes unnoticed."[28]

Most legal systems do not allow such double proof in the context of real security rights. If double proof is not allowed, the creditor would get only a percentage of the proceeds of the unencumbered assets based on the *unsecured* part of his claim.

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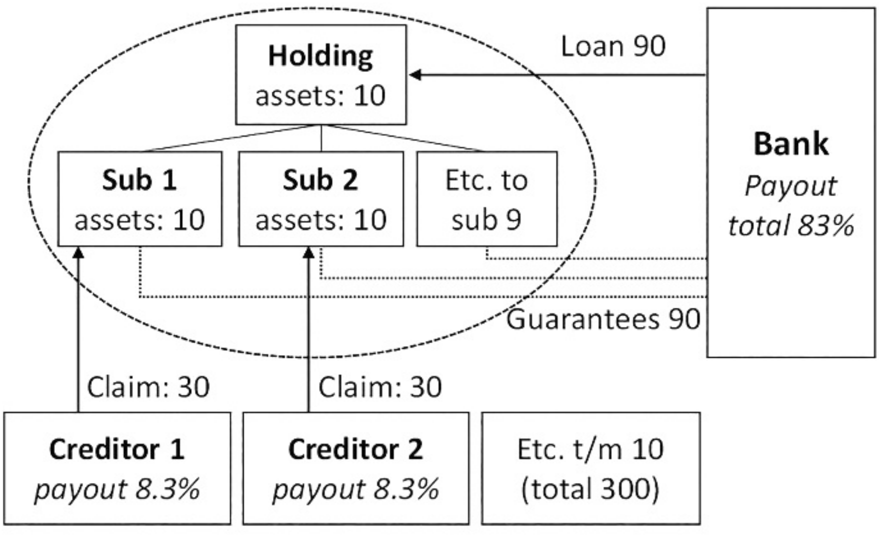
27 *See* further, also for other numerical examples, Widen, 2007, p. 307 ff; this example is not used to suggest that this would be the main reason for banks and companies to structure the company and the loan in this way. There are many reasons why subdividing into subsidiaries may be functional; *see also* E.B. Rock, "Adapting to the new shareholder-centric reality," *University of Pennsylvania Law Review*, 2013, pp. 1968-1969.

28 Widen, 2007, p. 309.

Figure 2 Strong-form double proof



From the perspective of the bankruptcy proceeding of an individual group entity of a bankrupt group, double proof can also lead to odd results. Assume an individual group company that is relatively small, for example with a balance sheet total of 300.000, whereas the group has a balance sheet total of 50 million. The group, as a whole, may have used a credit line of 20 million, guaranteed by all individual group companies. The total of creditors (other than the bank) of the individual group company could be 400.000, whereas there could, after liquidation, only be 200.000 in assets to distribute, amounting to a payout of 50%. However, the bank also submits its claim of 20 million, even though this individual group company obviously did not use the full credit facility of 20 million. Admission of this claim would reduce the payout to creditors to roughly (200.000 divided by 20.4 million =) 1%. The 200.000 thus almost entirely goes to the guaranteed bank, the other creditors are left with barely nothing, while they (probably) actually extended credit to this entity, whereas the bank merely extended credit to the group as a whole.

Cases become extreme when real security rights are taken into the equation. What if the credit line in the preceding example was almost fully secured, for example with 19 million worth of real security rights. Allowing the creditor to still submit a claim of 20 million in the bankruptcy cases of subsidiaries that have not granted real security rights would look strange. Things get even stranger when the possibility of credit bidding is also taken into the equation. What if the secured and guaranteed creditor uses the guarantee claim to place a credit bid on the assets on which he has security rights? He could make a bid up to the face amount of the claim, without having to pay anything (as he holds the security right), thus keeping a strong grip on the assets. Still, a rule that allows double proof would allow him to still claim the same amount in the bankruptcy cases of other subsidiaries (or to make more credit bids) that have guaranteed the debt.

The preceding example (figure 2) may need some explanation in regard to the nature and appearance of double proof. If the bank in the example extended a total of 90 credit to 10 group companies, and thus has a claim of 90 on each, the strongest version of double proofing would mean that, in the case of a group insolvency, the bank can claim 90 in each insolvency, disregarding any payments the bank receives on the debt after the date of bankruptcy filing. I call this *strong-form double proof*.

Two variations can be conceptualized. In the first, the bank would only be allowed to submit his deficiency claim in each insolvency, which would mean 90 in the first and, if the payout in the first is 8.3% (= 7.5) (as in the preceding example), 90 minus 7.5 = 82.5 in the second, etc. This could be referred to as *deficiency double proof*. Deficiency double proof essentially still allows for double proofing, but just for smaller amounts. If the guaranteed creditor can share pro rata in the distribution in the first bankruptcy based on a claim of 90, and after receiving 7.5 can share pro rata in the second bankruptcy based on a claim of 82.5, double proofing still occurs but just for smaller amounts. The guaranteed creditor now gets a combined return of roughly 72%,[29] compared with (on average) 12%[30] for the other creditors. Although he only extended 90 of credit, he is able to, in the ten bankruptcy cases combined, assert a total claim of 593[31] (down from 900 in the case of strong-form double proof), squeezing down ordinary creditors that are only able to assert the amount of their claim once and in one bankruptcy proceeding. In short, if the guaranteed creditor is only allowed to assert deficiency claims against each codebtor, double proof still occurs, but just in a weaker form.

Dutch law allows *strong-form double proof*; the 800-pound gorilla indeed goes unnoticed. Article 136 Fw regulates some specific questions that could arise in the context of an insolvent principal debtor who is the beneficiary of a guarantee relationship. This provision, that generally applies to debtors that are severally liable, states in paragraph 1 that the creditor can submit the full amount of his claim, measured on the day of the declaration of bankruptcy, in the insolvency proceedings of his debtor, and if there are more bankrupt severally liable debtors, in each insolvency proceeding. In essence, this article stipulates that *strong-form double proof* is allowed without restrictions. If, for ex-

29 The payment per bankruptcy case (in the example of figure 2, but with a rule of deficiency double proof) is then: ((10/120) × 90 = 7.5) + ((10/112.50) × 82.5 = 7.3) + ((10/105.2) × 75.2 = 7.15) + ((10/98.05) × 68.05 = 6.94) + ((10/91.11) × 61.11 = 6.71) + ((10/84.4) × 54.4 = 6.45) + ((10/77.95) × 47.95 = 6.15) + ((10/71.8) × 41.8 = 5.82) + ((10/68.98) × 38.98 = 5.65) + ((10/63.33) × 33.33 = 5.26) = total 64.93 payment on a claim of 90, which amounts to a 72% pay-out.

30 The total of assets in all bankruptcies combined was 100. 100 minus 64.93 (*see supra* footnote 29)= 35.7, which is the total distribution to the other creditor, who together have a total claim of 300. 35.7/300 × 100% = 12%.

31 *See* footnote above, 90 + 82.5 + 75.2 + 68.05 + 61.11 + 54.4 + 47.95 + 41.8 + 38.98 + 33.33 = 593.33.

ample, five severally liable debtors are declared bankrupt on the same day and the creditor has a claim of 100 on them, the creditor can submit 100 in each insolvency proceeding. If he gets paid 20 in one bankruptcy proceeding on, say, day 10, he can, also after day 10, still pursue a claim of 100 in the proceedings of the other four. Article 136 paragraph 1 Fw is a strange exception to the rule of Article 6:7 paragraph 2 BW, which stipulates that performance by one severally liable debtor discharges the other debtors as well.

Strong-form double proof was widely criticized in Dutch legal literature in the late 19th century[32] and is (not surprisingly) still criticized,[33] but changes have never been considered by the legislature or courts, which is striking given the fact that double proof is not allowed with real security rights. If the creditor has real security rights, he can submit only the unsecured part of the claim in the insolvency of the debtor (Art. 59 Fw), not the full claim. No attention whatsoever has been given to the problem of *deficiency double proof*. Even the critics of *strong-form double proof* did not discuss that the same problem essentially remains in a slightly weaker form when only deficiency claims on guaranteed debt can be submitted.

Double proof becomes especially problematic in relation to credit bids. The term credit bidding is used to describe a practice in which a creditor with security rights over certain property bids on the property in an execution sale. Such a bid is done in paper money, as the receiving party is the creditor himself, at least in as far as the creditor has an outstanding claim. The creditor can thus make a bid up to the amount of his outstanding claim without having to provide actual money. As discussed earlier, creditors, in the context of group finance, can have artificially high claims on all group entities because of guarantees. Without any considerable brakes on either double proof or credit bids, the creditor could use these artificially high amounts to make artificially high credit bids on all the property over which he also holds real security rights, thus keeping strong control over the debtor's property, without such credit bids affecting his claims over other group companies (although one could argue that making such bids again and again allows the creditor to, on paper, receive more than 100%, which should not be allowed). Dutch law does not provide any substantial brakes on credit bidding.[34]

32 *See* for an overview W.H. van Boom, *Hoofdelijke Verbintenissen*, Deventer, W.E.J. Tjeenk Willink, 1999, pp. 84-88.

33 Van Boom, 1999, pp. 87, 237-238; C.J.M. Klaassen, "10 Jaar Hoofdelijkheid en Borgtocht naar 'NBW'," *in* Kortmann, Janssen, Solinge & Faber, *Onderneming en 10 Jaar Nieuw Burgerlijk Recht*, Deventer, Kluwer, 2002, p. 696; *See*, however, G.J.L. Bergervoet, *Borgtocht*, Deventer, Kluwer, 2014, who approves of the extra bonus for the creditor, arguing this accommodates expedient settlement of the insolvency proceedings.

34 *See also* R.J. de Weijs & G.A.C. Orban, "Loan-to-Own meets Credit Bid: Credit Bidding naar Amerikaans en Nederlands recht," *Tijdschrift voor Insolventierecht*, No. 3, 2016, pp. 111-119.

5 Selective Payments to Guaranteed Creditors

Not unrelated, but clearly distinguishable from the treatment of pierced group structures and double proof is the behavior that the guarantee incentivizes *after* concluding the guarantee. Guarantees are likely to influence the borrower to favor the guaranteed lender above others by making payments or in another way transferring value to the guaranteed lender before insolvency. In other words, the guarantee creates incentives to act opportunistically in favor of the guaranteed lender to the detriment of other creditors. The reason why is simple. The incentives of the guarantor are clearly influenced by the guarantee relationship: the guarantor will have a high preference for preventing default of the debtor in relation to the guaranteed creditor and will care less about default of the debtor toward other creditors. There will, in other words, be an incentive for selective payment of the guaranteed creditor. Illustrative is the explanation of a bank manager interviewed by Mann on the question of why he requests guarantees from managers/shareholders of borrowers:

> When we get into trouble, where the company runs into difficulty, we find that the borrower's owners are much more willing to help us when they're personally liable.[35]

Simply put, the guarantee relationship by an insider leads to preferential treatment of the guaranteed creditor, from which the noninsider creditor also profits. The same, of course, applies to guarantees of group companies for other group companies. The group companies will have a high preference for paying off guaranteed debt first, as such payments indirectly lower the exposure of other group companies toward the guaranteed creditor. In the case of distress, this incentive becomes stronger. A guarantee could thus be seen as a promise to make preferential payments on the eve of bankruptcy.

This section will discuss how Dutch law deals with such preferential payments. Various mechanisms under Dutch law that may be relevant in this context are discussed below: first and foremost, preference law, but also shareholder liability, director liability, and lender liability. This section concludes that Dutch law hardly regulates the dynamics, thus leaving too much room for opportunistic preferential payments.

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35 R.J. Mann, "The Role of Secured Credit in Small-Business Lending," *The Georgetown Law Journal*, Vol. 86, No. 1, 1998, p. 24, quoting from an interview with Carmen Mastroianni, Senior Vice-President, Chase Manhattan Corp.

5.1 Preference Law

Transaction avoidance law may deter the leverage that a lender can obtain through a guarantee, thus deterring the incentive for insider dealing. If a principal debtor is in financial trouble, he or persons involved in the principal debtor (if the principal debtor is a company) may have incentive to give preference to a guaranteed lender above other creditors. This could happen in the context of group finance, in which a parent company may prefer its subsidiary to pay creditors guaranteed by the parent before other creditors when the subsidiary is approaching bankruptcy or, in the case of small-business finance, in which a shareholder or manager that guaranteed business debt may have the same inclination. The motivation to pay off guaranteed debt first is driven by the fact that the guarantor indirectly profits from such payments, because his exposure under the guarantee is reduced by the same amount. In Dutch law, there is no specific regulation dealing with the problem of the indirect profit that the guarantor receives by limiting his exposure through influence on the principal debtor.[36] Dutch transaction avoidance law has great difficulty dealing with such indirect preferences.

Dutch transaction avoidance law does not clearly distinguish between preferences given to a creditor and other actions of the debtor that have diminished the insolvent estate. Instead, a distinction is made between legal acts (*rechtshandelingen*)[37] that were voluntary in the sense that there was no legal obligation to perform the act (Art. 42 Fw) and legal acts that were obligatory (Art. 47 Fw). Legal acts that were obligatory, such as due payments, are generally near impossible to avoid, whereas legal acts that were voluntary can more easily be avoided. The test for the latter is whether the creditors have been prejudiced and whether both debtor and counterparty had knowledge of such prejudice to creditors (Art. 42 Fw). The Dutch Supreme Court has a very broad understanding of prejudice to creditors, so this will often be easy to show.[38] Knowledge of prejudice to creditors is explained as having been able to foresee bankruptcy of the debtor and a shortfall in such a bankruptcy with reasonable probability.

If a payment on a guaranteed debt was voluntary, avoidance of the payment is, in principle, rather simple, though not because of the existence of the guarantee, but simply because Article 43 paragraph 1 sub 2 Fw presumes that payments within one year prior to insolvency on debts that are not due were accompanied by knowledge of prejudice to creditors on both the side of the principal debtor and that of the counterparty (the guar-

36 *See also* R.J. De Weijs, "Financieren met Garanties door Aandeelhouders: Vergeten Problematiek," *FIP: Tijdschrift Financiering, Zekerheden en Insolventierechtpraktijk,* No. 6, 2010, p. 162.

37 Only legal acts can be avoided with transaction avoidance law. Other actions of the debtor that have been detrimental to the creditor cannot be attacked by transaction avoidance law. In order to undo the consequences of such nonlegal acts, the bankruptcy administrator would often have to rely on unjustified enrichment (Art. 6:212 BW) or tort (Art. 6:162 BW).

38 Dutch Supreme Court October 19, 2001, ECLI:NL:HR:2001:ZC3654, NJ 2001, 654 (Diepstraten/Gilhuis q.q.); Dutch Supreme Court July 8, 2005, NJ 2005, 457, JOR 2005/230 (Van Dooren q.q./ABN AMRO II).

anteed creditor). Rebuttal of the presumption will be difficult outside exceptional circumstances, as payment of undue debts at a moment that there are also (many) due debts to pay, will always be suspect. However, avoidance on the basis of Article 42 (in conjunction with Art. 43) Fw only allows payment to be retrieved from the direct counterparty of that payment, not from the person that indirectly profited from such payment (here the guarantor). The fact that the insider guarantor profits indirectly, and thus has engaged in insider dealing, is usually not considered directly relevant in this context.

The question whether there was prejudice to creditors in the context of a guarantee relationship has come before the Dutch Supreme Court in a somewhat complicated case. The parent company had guaranteed the debt of a subsidiary toward the bank. The parent company had also bought caravans from the subsidiary and paid the subsidiary for the caravans on the bank account of the subsidiary. Because there was an overdraft on the bank account, the payment essentially satisfied part of the claim of the bank and thus limited the exposure of the parent company toward the bank under the guarantee. The Court of Appeal had held that the sale of and payment for the caravans could not have prejudiced the other creditors, because a fair price was paid for the caravans. The Supreme Court, however, held that even though the price was fair, there was prejudice to the other creditors because the proceeds of the transaction went directly to the bank (and indirectly benefited the parent company), while the other creditors were left empty-handed (regarding these proceeds).[39] It is questionable how important the indirect benefit to the parent was for the Supreme Court to come to this conclusion. Also absent the guarantee, the Supreme Court would possibly find that there was prejudice to other creditors because the proceeds of the sale benefited only one creditor (the bank).[40] Thus, the reasoning of the Supreme Court in this case does not shed direct light on the treatment of guarantees in this context.

Payments made in accordance with a legal obligation to make such a payment are generally much harder to avoid by a bankruptcy administrator.[41] Article 47 Fw is written for avoidance of legal acts that were required by a preexisting legal duty, such as payment of a due debt. Such a payment can be avoided only in two categories of cases: (i) cases in

39 *See* Dutch Supreme Court May 22, 1992, NJ 1992, 526 (Bosselaar q.q./Interniber—also known as Montana I); this is in line with later case law of the Supreme Court on prejudice to creditors, giving a broad interpretation of prejudice: Dutch Supreme Court October 19, 2001, ECLI:NL:HR:2001:ZC3654, NJ 2001, 654 (Diepstraten/Gilhuis q.q.); Dutch Supreme Court July 8, 2005, NJ 2005, 457, JOR 2005/230 (Van Dooren q.q./ABN AMRO II). *See also* R.J. Abendroth, "Herfinanciering van de Onderneming," *in* G. van Solinge e.a., De financiering van de onderneming, Voordrachten en discussieverslag van het gelijknamige congres op 11 en 12 november te Nijmegen, Serie vanwege het Van der Heijden Instituut deel 88, Deventer, Kluwer 2006, pp. 58-59.

40 Dutch Supreme Court July 8, 2005, NJ 2005, 457, JOR 2005/230 (Van Dooren q.q./ABN AMRO II).

41 Professional creditors use this system by ex ante making sure, through their general terms and conditions, that giving in to any request they may want to make in difficult times of their debtor can be qualified as a "due payment." The creditor can thus, also when in bad faith, request the debtor to post additional security, which is "due" on the basis of the general terms and conditions. If the bankruptcy administrator wants to avoid the posting of additional collateral, he will have to invoke Art. 47 Fw, not Art. 42 Fw.

which the party that received payment knew that a request for bankruptcy of the principal debtor had already been filed in court, and (ii) cases of conspiracy between principal debtor and creditor to prejudice other creditors (Art. 47 Fw).

It is important to note that especially professional financial creditors are able to (and do) manipulate the distinction that Dutch law makes between obligatory and voluntary legal acts. If there was a preexisting duty to perform the act, the act is considered obligatory. The courts have interpreted obligatory legal acts very broadly. If, for example, a contract allows a counterparty under certain circumstances to ask for additional security or for repayment of the full loan, consequent granting of security or repayment, respectively, is considered to have been obligatory, and thus largely immune from attacks based on transaction avoidance law. The standard terms that all major banks in the Netherlands use therefore contain a provision that the debtor has to post additional collateral when the bank reasonably requests so. Thus, such additional collateral, even if posted on the eve of bankruptcy and even if both debtor and creditor knew very well that bankruptcy of the debtor was soon to be expected, is probably immune from transaction avoidance attacks.

As already stated, an obligatory legal act can be avoided only in two categories of cases: (i) cases in which the party that received payment knew that a request for bankruptcy of the principal debtor had already been filed in court and (ii) cases of conspiracy between principal debtor and creditor to prejudice other creditors (Art. 47 Fw). The first category applies only to a very small number of cases and will, even if applicable, often be hard to prove for a bankruptcy administrator, unless the creditor himself filed for insolvency of the principal debtor before receiving the obligatory payment.

The Dutch Supreme Court has, furthermore, developed a rather narrow interpretation of "conspiracy" as referred to in Article 47 Fw. The landmark cases on this point are Gispen q.q./IFN[42] and Cikam/Simon q.q.[43] In Gispen q.q./IFN, the Dutch Supreme Court considered that conspiracy as referred to in Article 47 Fw should be understood to mean that both parties have intentionally and willingly prejudiced the other creditors of the principal debtor by paying this particular creditor. In the case itself, the Dutch Supreme Court considered such intention not to be present on the side of the principal debtor, because he gave in to pressure from the creditor to make the payment, and thus did not have the intention to prejudice other creditors. In Cikam/Simon q.q., the Dutch Supreme Court confirmed the judgment of the Court of Appeal and also specifically the consideration of that court that conspiracy as referred to in Article 47 Fw could be presumed to be present under the circumstances of the case. Those circumstances were, simply put, that Cikam GmbH made a due payment to sister company Cikam B.V., while the financial situation of Cikam GmbH was very troublesome, and while Cikam B.V.

42 Dutch Supreme Court March 24, 1995, *NJ* 1995, 628 (Gispen q.q./IFN); *See also* Dutch Supreme Court November 20, 1998, «*JOR*», 1999/19, m.nt. NEDF (Verkerk/Tiethoff q.q.).

43 Dutch Supreme Court March 7, 2003, *NJ* 2003, 429 (Cikam/Siemon q.q.).

knew this as well, given the fact that the management of that company was in the same hands.

In the case of a due payment on a guaranteed debt, the conspiracy that has to be shown by the bankruptcy administrator in order to rely on Article 47 Fw is a conspiracy between creditor and principal debtor, not between guarantor and principal debtor. Even if such conspiracy between creditor and principal debtor can be shown, avoidance on the basis of Article 47 Fw, like avoidance on the basis of Article 42 Fw, allows only for retrieving the sum from the creditor, not from the guarantor that profited indirectly. The question then is whether the fact that the guarantor, through direct or indirect influence on the principal debtor, indirectly favored himself by the payment of the principal debtor to the creditor, is a relevant circumstance in order to come to a presumption that there was a conspiracy between *creditor* and principal debtor. The *Cikam* case[44] cannot be applied directly, not even in the case that the guarantor and principal debtor are group companies in the same hands, because there is no direct payment to a group company, just indirect profit. The answer to this important question thus remains open.

In a district court judgment, the court has found that a guarantee relationship was a relevant circumstance to decide that creditor and principal debtor had conspired. The case was, however, very specific. Creditor and guarantor (who was the director and indirect shareholder of the principal debtor) had discussed the difficult situation of the principal debtor, which led to granting the creditor additional security (which was due) in exchange for canceling the guarantee for the same amount.[45] Here, we see a clear case of conspiracy, with the principal debtor (as represented by the guarantor) and the creditor at the table, contriving how to enrich the guarantor and the creditor at the expense of other creditors of the principal debtor.[46] However, Faber claims in a case note that the reasoning of the district court, in which the district court derives the intention of the principal debtor to prejudice the guaranteed creditor above other creditors from the fact that the director bargained for a benefit for himself (partly cancelation of the guarantee relationship), is slightly blunt. That is not convincing. The fact that the director of the principal debtor bargained for a benefit for himself as guarantor, clearly gives the director, and thus the company, incentive to prejudice the guaranteed creditor above other creditors. If the principal debtor then, and only after the benefit for the director

44 Dutch Supreme Court March 7, 2003, *NJ* 2003, 429 (Cikam/Siemon q.q.).

45 Of course, if the guarantor guaranteed the full debt of the creditor, such canceling would practically not have any effect, because giving the creditor additional security would already have benefited the guarantor. However, in this case, as often happens, the guarantor had only partly guaranteed the debt of the creditor. As a result, the additional security given to the creditor may not have benefited him if the remainder of the claim after foreclosing on security rights would still have exceeded the maximum amount of the guarantee. To make sure the guarantor did benefit from the transaction, the arrangement was made that part of the guarantee relationship was canceled.

46 *See also* on the case: De Weijs, 2010, pp. 160-165; N.E.D. Faber seems to have a differing opinion in his comment to the case: Utrecht District Court June 6, 2007, *JOR* 2008, 19, m.nt. Faber (Aerts q.q./Rabobank and FGH).

was bargained for, posts additional security to the guaranteed creditor, there should be enough evidence to conclude that conspiracy between principal debtor and guaranteed creditor has taken place.

More relevant is, however, how far this reasoning can be stretched. In the case discussed, the guarantor could profit only if the creditor canceled part of the guarantee, because the unsecured part of the claim of the guaranteed creditor was higher than the maximum of the guarantee. Thus, posting some additional security by the principal debtor would not as such have benefited the guarantor. Some bargaining, and thus a clear conspiracy, was necessary to this end. A situation could, however, also occur, and does often occur, in which posting additional security by the principal debtor will benefit the guarantor because his exposure is reduced, without having to bargain for such a benefit. In that situation, there is a clear incentive for the guarantor to influence the principal debtor to post additional security, to secure the benefit for the guarantor. If this guarantor is an insider, such as a director, a shareholder, or a group company, this incentive can arguably be attributed to the principal debtor. Whether this as such suffices to establish conspiracy between principal debtor and guaranteed creditor, however, remains unclear. Dutch law is underdeveloped on such cases.

It could be inferred from the Bosselaar q.q./Interniber case of the Dutch Supreme Court[47] that there is some attention to the indirect benefit the guarantor can have through a guarantee relationship. However, this case, first of all, concerned another question (whether the sale of caravans to the shareholder for a fair price indirectly prejudiced other creditors), and, secondly, the guarantee relationship was, as already discussed, probably not essential in the reasoning of the Supreme Court that there was prejudice. In that sense, not much weight can be attached to this case in answering the question of whether a guarantee relationship can lead to a presumption of conspiracy in the sense of Article 47 Fw.

The problem with acknowledging that an insider guarantor can enrich himself (and the guaranteed creditor) at the expense of nonguaranteed creditors and that the principal debtor therefore has incentive to disadvantage nonguaranteed creditors is that this may lead to counterintuitive results for guaranteed creditors. The guarantee can then be used as a circumstance in a case on transaction avoidance of a payment of a due debt to that creditor. Thus, the guarantee could arguably lead to less security, instead of more.[48] However, such reasoning paints a distorted picture. It should not be forgotten that the guarantee was, probably, the reason that the payment was made. In that sense, the existence of the guarantee relationship made the incentive for the selective payment arise in the first place. Moreover, if this was not the case and other, nonguaranteed creditors also received due payments around the same time, the payment could be regarded as a normal and not suspect payment, which would make the case for conspiracy weak. Lastly, it should be

47 Dutch Supreme Court May 22, 1992, NJ 1992, 526 (Bosselaar q.q./Interniber—also known as Montana I).
48 *See also* De Weijs, 2010, pp. 160-165.

kept in mind that transaction avoidance only annuls the payment to the creditor, not the guarantee itself. After having reimbursed the insolvency trustee, the creditor can possibly call upon the guarantor under the guarantee relationship. In that sense, the creditor is not worse off. Of course, the creditor is still worse off if the guarantor is insolvent as well, but in such a case the guarantee did not really represent any value other than leverage over the guarantor.[49] Whether annulment of the payment indeed brings the guarantee back to life is, however, somewhat unsure, because the Dutch doctrine in principle recognizes only *relative effect* of the annulment. This relative effect means the annulment, in principle, has effect only as between the bankruptcy administrator and the counterparty of the payment.

The lack of attention to the problem that the guarantor is incentivized by the guarantee to prefer the guaranteed creditor (and thus indirectly himself as guarantor by limiting his exposure under the guarantee) is remarkable given the fact that the courts do seem sensitive to the potency of the guarantee relationship in influencing the decision making of the guarantor in another context. In the case *Leliveld/Rabobank*, the guarantor himself had argued that pressure exerted by the bank through (inter alia) the guarantee made him act in ways that were ultimately detrimental to his own interests, which argument has been followed by the court.[50] It is, however, much more likely that the guarantee makes the guarantor act in his own interest rather than the exceptional cases in which such pressure makes the guarantor act in a manner detrimental to his own interests. In that sense, it is all the more remarkable that the courts have little attention to this mechanism in the context of preference law.

Lastly, it should be noted that Article 47 Fw applies only to legal acts. Wealth transfers can remain covert, especially in cases where the wealth transfer is not a payment but another fact pattern that prefers the guaranteed creditor, such as a delayed bankruptcy filing or accelerated processing of raw materials. Because Article 47 Fw applies only to a legal act (*rechtshandeling*), such covert wealth transfers escape the (very limited) scrutiny of Dutch preference law in any case.

In short, Dutch transaction avoidance law fails to deal with indirect preferences. Dutch law distinguishes between avoidance of obligatory and voluntary acts. This distinction is somewhat flawed in the sense that it allows creditors to contract around it by ex ante making sure, using contractual provisions, that preferences given on the eve of bankruptcy will be qualified as obligatory payments. Avoidance of obligatory payments is generally difficult under Dutch law, and the circumstance that an insider such as a manager or shareholder has guaranteed the debt that was paid may arguably make avoidance of the payment easier, but what is very unclear is whether this is indeed the case and if it is, how much easier. Furthermore, in the case of both obligatory and voluntary payments,

49 J.L. Westbrook, "Two Thoughts About Insider Preferences," *Minnesota Law Review*, Vol. 76, 1991, pp. 73-98.

50 Court of Appeal Arnhem-Leeuwarden March 27, 2018, ECLI:NL:GHARL:2018:2893 (*Leliveld / Rabobank*).

Dutch law strongly relies on subjective factors that are often hard to prove. Relevant objective factors, such as the fact that an insider has indirectly profited from a certain transaction, hardly play a role, either in the statutory law or in the case law.

5.2 *Shareholder Liability for Unlawful Indirect Benefits through Guarantees*

A shareholder that has received an indirect benefit through a guarantee could act unlawfully (Art. 6:162 BW) in his role in creating such benefits, even when the payment or other act of the debtor that has created the benefit cannot be avoided by relying on transaction avoidance law. We can roughly distinguish between two types of unlawful shareholder behavior toward creditors.[51] The first category concerns liability because of unlawful distributions to shareholders, the second concerns unjustifiably continuing the company in difficult times. The first category is particularly relevant in the context of indirect preferences given through guarantees. When payments on company debts guaranteed by shareholders are made, the shareholder limits his exposure and thus indirectly receives a distribution. Payments on shareholder-guaranteed debts can thus be seen as covert distributions.

The Dutch Supreme Court has, in some exceptional cases, held that such behavior can indeed be unlawful toward creditors. In the *Keulen/Bouwfonds* case, Bouwfonds was in control of another entity (a nonprofit entity, a "Stichting" (foundation)) but withdrew and foreclosed on a loan when it heard that the local government would not finance the entity and quickly made sure its claim on the entity was fully satisfied.[52] The foundation had to liquidate, and all the creditors were paid only 65%. Keulen, one of the creditors, pursued Bouwfonds for its allegedly unlawful behavior. The Supreme Court held that the behavior of Bouwfonds could indeed be unlawful if it, when receiving the payment, should have seriously taken the possibility of a shortfall after liquidation into account. However, the Court of Appeal had already held that it was not sufficiently proven that Bouwfonds had an indication of such a shortfall.[53] The case shows that although establishing liability of a shareholder (or otherwise controlling entity) that seemingly favored himself as a creditor above other creditors is not easy on the basis of an unlawful act, a stricter norm applies to the liability of such a shareholder/creditor than to other normal creditors. Whereas a normal creditor will typically not act unlawfully when he receives payment in the vicinity of insolvency, not even if he knew of the financially deplorable

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51 *See* for this distinction: Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II* 2009, no. 842-843.

52 The relationship between Bouwfonds and the Stichting (foundation) can be seen as analogous to a parent-subsidiary relationship, *see* case note Van der Grinten to Dutch Supreme Court May 9, 1986, *NJ* 1986, 792 (Keulen/Bouwfonds).

53 Dutch Supreme Court May 9, 1986, *NJ* 1986, 792 (Keulen/Bouwfonds). *See* on the case Van Schilfgaarde, 1987, p. 84.

state of his debtor, the shareholder/creditor could act unlawfully if it can be proven that he knew of serious financial difficulties.[54]

Another case that deserves attention in this context is *Nimox*.[55] Nimox sold its claim, which was essentially a dividend payment turned into a loan, on its full subsidiary Auditrade to a third party that paid Nimox for the claim. That third party had an abundance of security rights, and could thus rank above other creditors, also for the claim bought from Nimox, in the bankruptcy of Auditrade that soon followed. Such behavior, essentially consisting of executing a decision to pay out dividend on a moment that this is clearly not justified and enforcing this dividend payment through a creative construction, can be unlawful according to the Supreme Court.[56]

Both in *Nimox* and in *Keulen/Bouwfonds*, the benefits received by the shareholder either directly or de facto amounted to withdrawals of share capital.[57] The accusation to the shareholder in such a case is that he pushes the corporation into a state of undercapitalization, which can be unlawful.[58] Payments that simply benefit a shareholder as an insider can arguably be distinguished from such withdrawals de facto of share capital, though of course dependent on what qualifies as de facto share capital.[59] Under current Dutch law, payments on third-party loans that are guaranteed by shareholders, in general probably do not qualify as withdrawals of share capital. Rather, as Barneveld also argues, such payments can be seen under the current law as, possibly, being in conflict with the paritas creditorum (Section 3:277 BW).

A good example of such a case is *Coral/Stalt,* in which the Supreme Court held, simply put, that a parent company is not free to favor itself as a creditor above other creditors after deciding to stop the activities of a subsidiary, except in special circumstances.[60] Two remarks should be made here. Firstly, the facts in the *Coral/Stalt* case present a rather extreme example, in which the decision to discontinue the business was already made before the payments to the shareholders were made. In other words, the payments were clearly part of a de facto liquidation of the business. The question remains whether a shareholder can already be held liable for the damage done by such payments in the period before the decision to discontinue.[61] Secondly, in *Coral/Stalt*, the debtor company directly favored the shareholder. The question remains whether the rule can be applied to the situation in which the debtor company pays an unrelated third-party creditor, for

54 Case note Van der Grinten to Dutch Supreme Court May 9, 1986, *NJ* 1986, 792 (Keulen/Bouwfonds).
55 Dutch Supreme Court November 8, 1991, *NJ* 1992, 174 (*Nimox/Van den End q.q.*).
56 Para. 3.3.1 of Dutch Supreme Court November 8, 1991, *NJ* 1992, 174 (*Nimox/Van den End q.q.*).
57 Compare Barneveld, 2014, pp. 481, 493.
58 Barneveld, 2014, pp. 481, 491.
59 *See* Barneveld, 2014, p. 495; of course, whether such a distinction can be made simply depends on the qualification of what is (de facto) seen as share capital. If an insider guarantee is qualified as share capital, limiting exposure under the guarantee is a withdrawal of share capital.
60 Dutch Supreme Court June 12, 1998, *NJ* 1998, 727 (Coral/Stalt); Barneveld, 2014, pp. 495-496.
61 *See also* Barneveld, 2014, pp. 495-496, who assumes this to be the case insofar as the involved actors understood or should have understood that bankruptcy was imminent.

which the shareholder acts as guarantor. The shareholder does not directly receive a payment in this case, but indirectly limits his exposure.

The facts in the *Sobi/Hurks* case show that guarantees can lead to preferential payments, but the Supreme Court does not seem to acknowledge this, or at least not explicitly.[62] The Court of Appeal had established that the shareholder should, from a certain date onward, have understood that new creditors would be prejudiced and held the shareholder liable for the debts of those new creditors (and did not hold the shareholders liable on the theory of unlawful distributions to shareholders). What happened after that date (but possibly also partly before) is that the principal debtor paid off debts with the bank, which the shareholder had guaranteed. The guarantee relationship can explain the behavior of the shareholder.[63] It could be that the shareholder fully understood that the subsidiary was not a viable company anymore, and that new creditors would from a certain moment on be prejudiced, but still kept this quiet and opportunistically waited with filing for insolvency in order to use the future incoming payments to limit its own exposure under the guarantee. Neither the Supreme Court nor the Court of Appeal seems to have fully acknowledged the guarantee as a relevant circumstance.[64] Moreover, if they had acknowledged this fact, it should have led to liability of the shareholder not only toward the new creditors, but also toward old creditors because they are also prejudiced by such indirect distributions to shareholders.[65]

As becomes apparent from the cases discussed, the Supreme Court has in some rather exceptional circumstances found unlawful behavior of a shareholder by favoring himself as a creditor present, while it also becomes apparent from the exceptional nature of these cases that such unlawful behavior is far from easy to show for another creditor or bankruptcy administrator. Concerning a shareholder that indirectly profits from payments made on a loan guaranteed by him, the creditor prejudiced by this will at least have to show that the shareholder should have seriously taken bankruptcy, and the possibility of a shortfall in that bankruptcy, of the company into account at the moment of receiving the indirect benefit. However, as case law on such indirect benefits in this context is currently absent, even that may not prove sufficient. The objective fact that a guarantee by a shareholder plays an important role in the dynamics is not recognized as such.

5.3 Director Liability for Insider Preferences

An important deterrent force on insider dealing with guarantees in the context of business finance may come from director liability rules for such behavior. Roughly two situa-

62 De Weijs, 2010, p. 163.
63 *Id.*
64 *Id.*
65 *Id.*

tions should be distinguished in this context: (a) payment of the guaranteed debt has just prejudiced other creditors and (b) payment of the guaranteed debt has both prejudiced creditors and damaged the company. The latter situation really is the exception and is mostly of theoretical interest. Payments to creditors normally do not damage the debtor itself. This category is therefore left out of the discussion. The distinction is relevant in light of director liability, because, under Dutch law, the rules on director liability toward the shareholders and/or the company differ from the rules on director liability toward outsiders such as creditors.

Creditors of the company and bankruptcy administrators can pursue directors of the company for unlawful behavior in the case that serious blame can be attributed to a director because he or she has effectuated, or allowed, that the company does not live up to its statutory or contractual obligations, while the director should have understood that the behavior of the company that he or she has allowed or effectuated would result in a failure to meet its obligations and that the company would also not provide sufficient opportunity for recovery.[66] In the case of unlawful behavior that falls in this category, generally both the individual creditors and the insolvency administrator (on behalf of the joint insolvency creditors) could bring a claim against the director for such unlawful behavior.[67]

This category of debtor liability can be relevant in the context of payments on debts guaranteed by shareholders and/or directors of the debtor, although the relevance of such guarantees to the application is rather unsure. Generally, directors are free to choose whom to pay first, but this can change near insolvency. If the directors are aware of the serious financial difficulties of a company and that a certain payment will prejudice the other creditors, they would be acting unlawfully if they made the payment anyway.[68] It is clear that directors who (can) foresee that insolvency is unavoidable are not allowed to make selective payments to creditors anymore and will be liable for the damage done to creditors if they represent the company in making such payments anyway. Somewhat unclear in the doctrine is whether selective payments made to insiders, such as shareholders, group companies, or the directors themselves, can be unlawful already before selective payments to outsiders would be unlawful. This indeed follows from both the

66 Dutch Supreme Court December 8, 2006, *NJ* 2006, 659, ECLI:NL:HR:2006:AZ0758 (Ontvanger/Roelofsen); the Supreme Court has also recognized another category of unlawful behavior of directors toward creditors, but this other type is generally not relevant to cases of selective payment. This type concerns directors to which serious blame can be attributed because of representing the company in contracting with third parties, while they knew or should have known that the company would not be able to perform and would also not provide sufficient opportunity for recovery (Dutch Supreme Court October 6, 1989, NJ 1990, 286 (Beklamel)).

67 Dutch Supreme Court January 14, 1983, *NJ* 1983, 597 (Peeters q.q./Gatzen); Dutch Supreme Court December 21, 2001, *NJ* 2005, 95 (Lunderstadt/De Kok c.s.).

68 Dutch Supreme Court December 8, 2006, *NJ* 2006, 659, ECLI:NL:HR:2006:AZ0758 (Ontvanger/Roelofsen); Den Bosch Court of Appeal, January 19, 2010, *JOR* 2010/113 (Stoets Holding/Bohncke); Arnhem Court of Appeal, September 15, 2009, *JOR* 2010/112 (Beijer/Willems q.q.).

Beijer/Willems q.q. case of the Arnhem Court of Appeal and the *Stoets/Bohncke* case of the Den Bosch Court of Appeal.[69] In the latter case, the Court of Appeal explained that even though selective payments to creditors are generally allowed even in difficult times, the circumstances of the case, such as the fact that only insiders were paid, can lead to the conclusion that the directors have acted unlawfully.[70]

However, that still leaves the question on indirect payments to insiders somewhat open. A payment on a loan guaranteed by an insider is not a direct payment to an insider, but an insider indirectly profits. This circumstance arguably makes qualification of a selective payment in difficult times as unlawful more likely, but Dutch law is unclear and underdeveloped on this point. Moreover, even if such selective payments are unlawful because of the moment at which they were made in combination with the fact that an insider profited, there is, in the current doctrine, possibly still room for justification.[71] Such a justification could arguably be more likely to be accepted by a court in cases of payments that only indirectly benefited insiders than in cases of direct selective payments to insider creditors.[72]

A judgment of the Amsterdam Court of Appeal (*Pieper/Mentzel c.s.*) illustrates that point well.[73] The accusation had been made toward the director that the available funds (more than 1 million Euro) had been almost exclusively used to pay off debts for which the director was personally liable toward those creditors. The payments had thus limited the exposure of the director under that contractual liability. The Court of Appeal first reiterates that a director should, also in the case of distress and when it is clear that not all creditors will receive full satisfaction from the available funds, have the freedom to pay those creditors on which the company is most dependent regarding the continuance of the business. The Court of Appeal acknowledges that if the director has indeed adjusted payments of the company to suit his personal interests of being released from a personal guarantee, the conclusion should usually be reached that the director has improperly managed the company. However, the court also directly relativizes this statement, by stating that the simple fact that a personal interest of a director is served by a certain payment does not mean that the director cannot justifiably make the assessment that the continuance of the company is coincidently also best served by that payment, which should thus also be made. In the case itself, the director had argued that the payments

69 Arnhem Court of Appeal, September 15, 2009, *JOR* 2010/112 (Beijer/Willems q.q.). Den Bosch Court of Appeal, 19 January 2010, *JOR* 2010/113 (Stoets Holding/Bohncke). In her case comment to the cases, Rijckenberg argues against such a distinction between payments to insiders and payments to outsiders, but instead argues that this distinction could have some influence on the question of whether the payment, if made after a point that directors should have understood that insolvency was very near, could be justified or not.

70 Den Bosch Court of Appeal, January 19, 2010, *JOR* 2010/113 (Stoets Holding/Bohncke), para. 8.6.1.

71 Dutch Supreme Court June 12, 1998, *NJ* 1998, 727 (Coral/Stalt).

72 Compare case note Rijckenberg, para. 13, Arnhem Court of Appeal, September 15, 2009, *JOR* 2010/112 (Beijer/Willems q.q).

73 Amsterdam Court of Appeal, ECLI:NL:GHAMS:2012:BW1995 (*Pieper/Mentzel c.s.*), r.o. 3.32.

were indeed in the interest of the company, and the Court of Appeal accepted this fact as not contested.

Although the Court of Appeal is not entirely clear on this, we could infer that the fact that certain payments have served the personal interests of a director because of a guarantee relationship with the creditor can help the claimant somewhat in proving that the director has behaved improperly, but not sure is how much this can help. The claimant should show that (1) the payment was made at a time in which the director should have understood that not all creditors would receive full satisfaction from the available funds and that (2) the director had a personal interest in such payments. It is then for the director to show that, although such personal interest existed, the payments were essential from a going concern point of view. If such a personal interest of the director would have been absent, the claimant would possibly also have to show that the payment was not strictly necessary, as the starting point of the Court of Appeal was that the director should be given the freedom to decide which payments are necessary. In other words, the existence of a personal interest of the director, here based on a guarantee, puts the burden of proof that the payment was indeed necessary from a going concern point of view on the director, whereas absent a guarantee the burden to show that the payment was not necessary from a going concern point of view lies with the claimant.

The question of liability of directors for preferring one creditor above another is particularly also relevant in the context where no payment was made but in which factual behavior of the debtor has preferred a certain guaranteed creditor (and indirectly thus the insider guarantor) above other creditors. Think of the example of continuing the business, or even speeding up the business, such as the processing of raw materials into a finished product, by which a certain creditor (automatically) gets a security right. Articles 42 and 47 Fw only apply to legal acts and are thus unable to police such behavior. The fact that Articles 42 and 47 Fw do not regulate such behavior does not compromise the possibility of a claim based on an unlawful act (Section 6:162 BW) on a director.[74]

6 Recommendations

This report has shown that Dutch law has little attention to the opaque dynamics that a group structure perforated by guarantees can create. Not only does Dutch law have little attention to piercing guarantees when considering veil-piercing cases, but it also fully allows double proofing of claims and hardly puts any brakes on preferential payments on guaranteed loans on the eve of bankruptcy. Three general recommendations are put forward to regulate the adverse dynamics created by perforated group structures:

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74 *See also* R. van den Sigtenhorst & B. Winters, "Bestuurdersaansprakelijkheid wegens benadeling van Schuldeisers En de Samenhang Met Pauliana," *in* Van Bekkum, Kreileman, Schuijling & Van Solinge, *Aansprakelijkheid van Bestuurders en Commissarissen*, Deventer, Kluwer, 2017, para. 15.4.4.

- Clearly recognize guarantees that pierce group structures as an important factor in decisions on veil piercing and substantive consolidation.
- Limit double proofing of claims through guarantees in the context of corporate groups.
- Limit the incentive for making preferential payments on guaranteed loans by:
  1. making avoidance of such preferential payments easier (after which the guaranteed creditor should be allowed recourse on the guarantor(s));
  2. making a direct claim by the bankruptcy administrator on the guarantor possible; and
  3. consider indirect profit to an insider guarantor (such as a group company) as an important factor in shareholder and director liability cases concerning damages because of preferential payments.