Voorrang bij verhaal: rechtvaardigingen en verklaringen

Uden, R.C.P. van

SUMMARY

Priority of claims. Justifications and explanations

I.

This dissertation is about the ranking of creditors seeking recourse for their claims against the assets of a bankrupt company. When a company goes bankrupt, this typically means that its assets are insufficient to fully satisfy all of its debts. This creates a situation of *concursus creditorum*, a concurrence of creditors (*samenloop van schuldeisers*). It is in this situation that the rules regarding the order of priority of claims (priority of claims law (*het verhaalsrecht*), as primarily laid down in Title 3.10 of the Dutch Civil Code) become relevant. These rules determine how the proceeds of the available assets should be distributed among the creditors and establish various sorts of priority rights: deriving from pledges and mortgages (*pand en hypotheek*), from different types of privileges (*voorrechten*), and from other grounds of priority as specified by law (*andere in de wet aangegeven gronden voor voorrang*). A question that arises in this context is *why* certain creditors are allowed to have prioritised recourse over other creditors against the debtor's assets. This question has a central place in this dissertation and is approached from two perspectives. First, the dissertation examines which academic theories on the *justification* of priority of claims can be identified and what they say about the content and scope of such priority. Secondly, it studies the Dutch legislator's approach to priority of claims, to *explain* why the current order of priority of claims is as it is. These perspectives are then compared, followed by an evaluation of the legislator's actions in this matter, after which recommendations are formulated for further development of Dutch priority of claims law. This structure is reflected in the main research question of this dissertation:

> What are the justifications for priority of claims according to academic theories, to what extent does the reasoning used in the legislative history of the Dutch law of priority of claims deviate from this, and in what direction should the law of priority of claims be developed in the light of these theories?

II.

To answer this question, this dissertation first examines the current ranking of creditors in Dutch priority of claims law.[1] It discusses the *pari passu* principle (*paritas creditorum*) as the standard of distribution in a *concursus creditorum* and the various exceptions to this standard. These exceptions can be divided into two categories. Firstly, the *pari passu* principle can be overridden by actions of the debtor and/or his creditors, such as (enforcing) payment, set-off, agreeing on subordination, and granting security interests

1 See chapter 2.

(like pledges and mortgages).[2] However, these possibilities are not unlimited. In some cases, the courts have intervened to prevent excessive or unjust incursions into the *pari passu* principle.[3] The second category concerns cases where the law gives a preferential status to certain types of claims in a *concursus creditorum*. This concerns execution costs, privileges, and other grounds of priority as specified by law.[4] The discussion also covers the priority rights given by law to the tax authorities and the UWV (the Dutch Employee Insurance Agency).[5] Additionally, the distribution rules that apply to debt restructuring under a WHOA agreement are addressed.[6] The WHOA (art. 369 *et seq.* Dutch Bankruptcy Act) has its own system of distribution, which deviates from the general rules on the order of priority. Finally, the forgoing is mirrored against reality, based on CBS (Statistics Netherlands) data on the settlement of bankruptcies, showing that the value of a priority right in bankruptcy is generally limited.[7] This demonstrates that there is 'work to be done' in bankruptcy law to ensure that the system of priority of claims better serves its purpose.

III.

The search of an answer to the main research question continues with a study of the normative justifications for priority of claims in academic literature.[8] Three theories are identified in this dissertation that attempt to justify the existence of priority rights. Each of these theories focuses on justifying the priority of secured creditors. The first theory is that priority – specifically, the high-ranking priority of secured creditors – is justified by the fact that the debtor is free to dispose of his assets and therefore also to grant priority rights to some of his creditors (in the form of security interests).[9] This theory fails to convince. The assumption underlying this theory, *viz.* that granting a security interest over an asset does not fundamentally differ from the outright transfer (*overdracht*) of that asset and should therefore be treated similarly, does not hold. There are good grounds for considering that granting a security interest has a nature of its own, distinct from that of a transfer. While this freedom of disposition justifies the *presence* of priority for the secured creditor, it leaves room for further *shaping* this priority (determining its rank) based on other justifications.

Law and economics theory also provides for a justification of priority of claims, again focusing on the priority of security interests. The theory here is that the positive social welfare effects associated with security interests – which partly also arise from the priority – explain this priority.[10] At the same time, this does not mean that further welfare improvements cannot be achieved. For example, it is arguable that the positive welfare effect of monitoring increases as the priority position of the monitoring party in a potential *concursus* is lowered, as long as there is specialisation in monitoring.[11] For the position

2 See § 2.3.
3 See § 2.3.5.
4 See § 2.4.
5 See § 2.4.3 and § 2.4.4.
6 See § 2.5.
7 See § 2.6.
8 See chapter 3.
9 See § 3.2.
10 See § 3.3.3.
11 See § 3.3.3.2.

of secured creditors in the order of priority of claims, this means that there is room for lowering their priority position. Viewed solely from the perspective of monitoring, this has a positive welfare effect. In addition to the positive welfare effects, there is also a negative welfare effect for the non-adjusting creditors, who for various reasons cannot offset their increased credit risk (due to the granting of the security interests) in their relationship with the debtor. There is, then, an efficiency gain to be achieved if this negative welfare effect can be reduced in a way that results in a net increase in welfare. In the context of ranking of claims, initiatives have already been developed to introduce – partial or absolute – priority over secured creditors.[12] The room for efficiency gains lies in changes to the order of priority of claims where the welfare increase (primarily benefiting the non-adjusting creditors) is greater than the welfare decrease (primarily affecting the secured creditors). Of the initiatives examined, a fixed fraction priority rule, as focused as possible on priority for non-adjusting creditors, seems to have the best potential to lead to a net efficiency gain.

In the literature, the (societal) interest of business continuity outside (imminent) bankruptcy has also been used to justify the high priority of secured creditors, specifically those in the banking sector. However, this justification falls short, or at least the arguments used – the secured creditor grants credit and undertakes monitoring activities – are unconvincing because they are insufficiently distinctive. Moreover, this dissertation argues that rewarding monitoring by granting a priority position is inherently inappropriate.[13] The best monitoring (from the perspective of all creditors) is done by a party that will not have any priority position in the event of bankruptcy. In a situation of (imminent) bankruptcy, the dynamics are somewhat different. This dissertation examines the extent to which the interest of business continuity provides a ground for weakening the special enforcement position (*separatistenpositie*) of pledgees and mortgagees, who are entitled to enforce their security interests as if there were no bankruptcy. This is particularly relevant in debt restructuring – in a bankruptcy or in a WHOA procedure – where these creditors might disrupt the continuity of the business by enforcing their security interests. In this situation, the interest of business continuity may require that the power of these creditors is being weakened, although this may not lead to undermining their security position.[14] Thus, this justification does not provide a ground for lowering the rank of the secured creditor in the order of priority of claims.

All in all, the analysed academic theories show that primarily the debtor's freedom of disposition and law and economics theory provide a justification for granting priority to secured creditors in the order of priority of claims. Uniquely, law and economics theory also provides a basis for determining the specific rank of this priority. This theory allows for a different view than that secured creditors should have a high priority. Further efficiency gains seem possible by adjusting the order of priority in favour of non-adjusting creditors.

IV.

As regards the Dutch legislator's approach to priority of claims, this dissertation examines which arguments for prioritised recourse have played a meaningful role in the legislative

12 See § 3.3.4.
13 See § 3.4.2 and § 3.4.4.
14 See § 3.4.3 and § 3.4.4.

history of the law of priority of claims since the introduction of the Civil Code of 1838 (*OBW*) and how these arguments explain the development of priority of claims law during this period.[15] Concerning civil privileges (*privaatrechtelijke voorrechten*), it is notable that the reasons for their existence are diverse and reflect the policy objectives pursued by the legislator. This is evident in the specific interests behind certain privileges (such as the marketability of apartment rights). Over the years, privileges associated with claims arising in the interest of all creditors and privileges serving a social interest have proven to be the most enduring. At the same time, it became apparent during the recodification of the Civil Code that a privilege is not always the right mechanism to serve social interests. Creditors dependent on periodic payments from the debtor are more served by the continuation of these payments through a public law scheme (like the Dutch wage guarantee scheme (*loongarantieregeling*)) than by a deferred final payment in bankruptcy.

Regarding the (high-ranking) priority of the tax authorities, it is notable that the question of its justification was insufficiently addressed in the first half of the twentieth century. Where the justification *was* questioned through effective lobbying, this questioning was limited to the rank in relation to the priority of secured lenders. Here, the interest of sufficient credit availability associated with the latter priority was an argument to revise its rank relative to the tax priority. For the rest, the rank of the tax priority was left untouched. Attempts from the 1950s onward to reassess the justification for this high-ranking priority and to incorporate this in a revaluation of this priority by the legislator, were unsuccessful. By invoking the significant budgetary interest of the state in maintaining this high priority, the government has so far managed to avoid any legislative change in this matter. During the recodification process leading to the New Civil Code (*NBW*), the principal drafters (professor Meijers and later government commissioner Snijders) deliberately excluded this priority from the legislative drafts. The subject was beyond the sole influence of the Ministry of Justice, was particularly sensitive, and thus posed a threat to the progress of the codification project. For pragmatic reasons, Meijers and Snijders limited themselves to the most necessary changes in priority of claims law. A comprehensive revision of the system of priority of claims – based on the report of the Houwing committee – was postponed and moved to a separate legislative proposal (Bill 22 942). The legislative work on this proposal, however, soon paused, and eventually, after almost thirty years of dormancy, the proposal was withdrawn in 2022.

Given the above, it is no surprise that in recent years the strengthening of the recourse position of the ordinary creditors (*concurrente schuldeisers*) has emerged as an argument for a fairer distribution of the bankruptcy estate. After all, the stagnation in the further development of the system of priority of claims is most visible among the group of creditors with the lowest rank in a *concursus*. Considering the foregoing, this dissertation concludes that the development of Dutch priority of claims law from the twentieth century onwards has been mainly driven by pragmatism. The legislator has consistently acted reactively, avoiding controversy, and has repeatedly postponed the most contentious issues. As a result, many of the substantive arguments behind the revision proposals of the Houwing committee have unjustifiably not played a role in the development of Dutch priority of claims law in the (New) Civil Code. Pragmatism has so far prevailed over substance.

15 See chapter 4.

V.

The comparison of the two previous perspectives reveals that the legislator's approach to priority of claims does not align well with academic theory on priority of claims.[16] It is particularly striking that the legislator pays much less attention to the position of secured creditors in the order of priority, and where attention is paid, the nuanced view presented by academic theory is not recognised. At the same time, the comparison shows that the legislator's actions, with regard to pursuing societal interests, cannot be fully captured by the examined theories. Thus, academic theory and the policy objectives of the legislator should complement each other in the (further) development of the law of priority of claims. The comparison further shows that the legislator's approach to priority of claims is characterised by continuing the existing system. Fundamental innovations, such as those developed in theory or proposed by the Houwing committee, have repeatedly not been undertaken by the legislator. The foregoing deviations, which show a conservative development of priority of claims law, can be explained by powerful lobbying from finance practice and the Ministry of Finance, as well as the institutional phenomenon of path dependency, which is clearly visible in the legislative history of priority of claims law.

This comparison also provides an opportunity to evaluate the legislator's actions regarding priority of claims. Here it is particularly noticeable that the legislator has fallen short in adequately addressing the negative consequences of security interests for non-adjusting creditors.[17] Not all legislative work in this matter, however, can be assessed with the examined academic theory. If this is so, the arguments used by the legislator are examined based on their own normative force.[18] Here it is found, among other things, that the rank of the costs of filing for bankruptcy (*faillissementsaanvraag*) is lower than the underlying interest justifies, and that the passing (*overgang*) of privileges through subrogation should be the exception rather than the general principle. Moreover, the arguments used to justify the existing high tax priority are also unconvincing, and the two strongest tax priority rights (*bodemrecht* and *bodemvoorrecht*) impair – from a law and economics perspective – the positive welfare effects associated with security interests. This calls for the abolition of these priority rights and for lowering the rank of the general tax privilege (*algemene fiscale voorrecht*). It is also recommended to align the rank of this general tax privilege with the rank of the other general privileges (*algemene voorrechten*), and to let them all rank *pari passu*.

This dissertation concludes by answering the question in which direction priority of claims law should develop, given the above.[19] It is argued that the legislator should introduce a scheme of fixed fraction priority over the priority of secured creditors, in a way that addresses both the negative consequences of security interests for the non-adjusting creditors and fills the gap left by the abolition of the *bodemrecht* and *bodemvoorrecht*. The INSOLAD proposal (2012) provides a good starting point for this purpose, which, in an adapted form (a comprehensive scheme that achieves both objectives), offers a blueprint for introducing this type of priority into current Dutch priority of claims law. It is about time the legislator took up the challenge and, guided by the insights of this dissertation, proceeded with the (long-postponed) revision of the law of priority of claims.

16 See § 5.2.
17 See § 5.3.1.
18 See § 5.3.2.
19 See § 5.4.