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Bankruptcy trustee's duty to supply information to holder of undisclosed pledge

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Introduction

Under Dutch law it is possible to pledge a receivable without notification to the debtor of the receivable – this is referred to as an undisclosed pledge. Until recently, it was unclear whether the holder of such a pledge is entitled to demand information about the debtor from the pledgor's trustee in bankruptcy where that information is necessary to enable the pledgee to disclose the pledge to the debtor. On October 30 2009 the Supreme Court held in the *Hamm/ABN AMRO* case that a trustee is obliged to supply the pledgee with such information. This ruling is favourable to banks and other secured creditors, although their position under Dutch law was already strong in many respects.

Creation of undisclosed pledge on receivables

An undisclosed pledge on receivables is created by either the execution of a deed before a Dutch civil law notary or the registration of a private (non-notarial) deed with the Dutch tax authorities. The pledgor and pledgee almost invariably opt for the latter option, as it is more efficient and much cheaper. Under Section 84(2) of Book 3 of the Civil Code, the creation of the pledge is valid only if the pledge instrument describes the pledged receivables in a sufficiently precise manner. In more general and abstract terms; it should be possible to determine the object of the pledge (referred to as the 'determinability requirement'). In many cases it is a challenge for banks to meet this statutory requirement as borrowers often have a large number of trade receivables.

Since the enactment of Section 84(2) in 1992, Dutch banks have devised several facilitated procedures to meet the determinability requirement. In the type of procedure eventually leading to the *Hamm/ABN AMRO* decision, which concerned events occurring in 1999, the pledgor submits to the pledgee/bank at regular monthly intervals a short standard pledge form of one page, to which various lists of the pledged receivables are attached. In the standard pledge form the pledgor grants the pledgee an undisclosed pledge over all receivables outstanding at the time of registration of the deed and which are set out in the separate lists of receivables. Only the one-page standard pledge form (containing the names of the first and last debtors on the lists) is registered with the tax authorities on a monthly basis.

In addition, the standard pledge form contains a catch-all clause, in which the pledgor also grants the pledgee an undisclosed pledge on (i) all other receivables which are in existence at the time the pledge is created, and (ii) all future receivables (as long as they arise directly from an existing legal relationship). The clause further specifies that it must be possible to determine in some way from the pledgor's books and records which receivables are the object of the pledge. This catch-all clause is intended to include all receivables which are not mentioned in the lists of receivables, but which meet the determinability requirement.

The Supreme Court's 2002 decision in the *Mulder/Rabobank* case made it clear that a simpler procedure is also possible; it is even sufficient to register with the tax authorities a single standard pledge form containing the catch-all clause, without submitting lists of the pledged receivables. The Supreme Court held that this form meets the determinability requirement in Section 84(2). In this case the pledgor had granted the bank an irrevocable power of attorney in advance to pledge receivables to

itself (on behalf of the pledgor) by means of a private deed to be registered with the Dutch tax authorities. This case also illustrates the Supreme Court's practical approach to the registration requirement. Since 2002, many banks have been following this procedure.

Pledgee may collect receivables after giving notice of pledge

The pledgee can collect the pledged receivables as soon as it has given the debtor notice of the pledge. After this notice, pursuant to Section 57 of the Bankruptcy Act, the pledgee may independently exercise its rights as if there were no bankruptcy. This means that the pledgee has the same rights during the pledgor's bankruptcy as it would have without the bankruptcy. Some international experts have even called the Netherlands the 'promised land' for secured creditors, as their position based on Section 57 is so strong.

However, as long as the debtor has not been given notice of pledge, the right to collect the receivable remains with the pledgor (or its trustee in bankruptcy). In the absence of such notice the trustee will often be tempted to open a new account with a financial institution other than that of the pledgee and to inform the debtors that any further payments should be made into that account. The Supreme Court held in the *Mulder/CLBN* case that if a trustee has collected a receivable in this manner, the pledge encumbering the receivable is extinguished together with the receivable itself. However, the (former) pledgee still maintains a priority right on the proceeds that have been collected by the trustee. This position is not altogether favourable, as the former pledgee will not be paid until the bankruptcy estate has been distributed and it will have to share in the general costs of the bankruptcy proceedings, with the end result that its payment will amount to little or nothing. Thus, the following question is very relevant to banks.

Can trustee collect receivables immediately?

As stated above, pursuant to Section 57 of the Bankruptcy Act the pledgee may exercise its rights independently as if there were no bankruptcy. Under Section 58 of the act, the trustee may set a reasonable period within which the pledgee must exercise its rights. The question arose of whether the trustee was entitled to collect the receivables immediately after having been appointed by the court, without having set the reasonable period provided for in Section 58.

In the 2007 *ING/Verdonk* case the Dutch Supreme Court held that in principle, the trustee can collect the receivables immediately (eg, passively, if the debtor pays the receivable of its own accord), but that it must grant the pledgee a reasonable period in which to notify the debtor. If the pledgee does not notify the debtor within this period, the trustee is entitled to inform the debtor that payments to the pledgor should be made into a bank account of the estate. In the case of a professional pledgee such as a bank, the reasonable waiting period to which the trustee must adhere is generally 14 days.

After the *ING/Verdonk* case, the question still remained of whether the the pledgor's trustee in bankruptcy must supply information to the pledgee about the debtor where that information is necessary to enable the pledgee to disclose the pledge to the debtor. Obviously, if the above-mentioned lists of receivables do not comprise all the pledged receivables or if there are no such lists, the bank needs the cooperation of the trustee in bankruptcy in order to identify the receivables that have been pledged under the catch-all clause.

***Hamm/ABN AMRO* ruling requires trustee to supply information to the pledgee**

In order to meet its obligations under a loan agreement in 1999, Autocar sent various standard pledge forms to ABN AMRO, creating an undisclosed pledge in favour of the bank on all of Autocar's present and future receivables from third parties. Attached to each standard pledge form was a list containing the receivables in existence when that form was sent. The last standard pledge form (which was registered with the tax authorities on August 4 1999) contained a catch-all clause.

ABN AMRO argued that Autocar's trustee in bankruptcy was obliged to supply it with information about the debtors of the receivables pledged under the catch-all clause. The Supreme Court decided the case in favour of ABN AMRO, holding that it was in keeping with the essence of an undisclosed pledge that the pledgor's trustee be obliged to supply the pledgee, at the latter's request, with all information concerning the debtors which the pledgee needs to disclose the pledge and collect the receivables. The court held that if the trustee were not obliged to give this information, the pledgee would have very little opportunity to exercise its rights under Section 57 of the Bankruptcy Act. In return for having supplied information to the pledgee and having allowed the pledgee to inspect the pledgor's books and records, the trustee was entitled to reimbursement for the reasonable expenses incurred.

The Supreme Court also ruled that as soon as the holder of an undisclosed pledge gives the trustee notice that it wishes to exercise its rights, the trustee must refrain from any activity aimed at collecting the pledged receivables on behalf of the estate. It makes

no difference whether the notice is given within the 14-day waiting period.

Comment

On the basis of the *Hamm/ABN AMRO* decision, the bank/pledgee should, as soon as possible after the borrower/pledgor is declared bankrupt, (i) notify the trustee that it intends to exercise its rights, and (ii) give notice of the pledge to the debtors. After receiving this notice, the debtors may discharge their payment obligation only by paying the pledgee (and not the trustee). Some experts even argue that the pledgee may notify the trustee in advance through a provision in the loan documentation stating that on the occurrence of the borrower's bankruptcy, it will disclose the pledge to the debtors and subsequently exercise its rights.

This ruling is in line with a series of decisions in which the Supreme Court has, when given a choice between interpreting the rules on an undisclosed pledge of receivables in such a way as either to decrease the usefulness of this type of security interest to creditors or to increase its usefulness, opted for the latter. The court's holding that the pledgee's right to obtain information is consistent with the essence of an undisclosed pledge goes hand in hand with its flexible interpretation of the statutory requirement in Section 84 of Book 3 of the Civil Code. One of the consequences of decisions such as *Mulder/Rabobank* (which held that the use of a single standard pledge form with a catch-all clause is sufficient) is that the pledgee often has limited knowledge of the identity of the debtors of the pledged receivables. This entails that the relative convenience with which an undisclosed pledge can be created is of little use to the pledgee if the pre-conditions for enforcing its pledge on the receivables are not met. Thus, the Supreme Court's construction of the trustee's duty to supply information is a continuation of its earlier case law on the determinability requirement.

Generally speaking, the *Hamm/ABN AMRO* decision is in line with the general nature of the Netherlands as a pro-creditor jurisdiction, in which individual creditors have ample room to protect themselves through security interests.

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