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Luxembourg Modernises Its Insolvency Legislation

By Jan Boeing, Geoffrey Delamarre and Tanner J. Wonnacott*

In this article, the authors review Luxembourg's new insolvency law.

The parliament of the Grand Duchy of Luxembourg (Luxembourg) has passed bill no. 6539A into law (the New Insolvency Law), marking a significant milestone in the movement to modernise and enhance the competitiveness of Luxembourg's insolvency framework. The bill has been under discussion for a number of years and aims to curtail the use of bankruptcy as an insolvency solution in favour of the preemptive preservation or reorganisation of financially distressed companies. It implements Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks into national law.

The New Insolvency Law has come into force on November 1, 2023, and introduces novel preventative options for financially distressed companies, both in and out of court, for the avoidance of bankruptcy.

Further, the New Insolvency Law discards several facets of the Luxembourg insolvency framework, which had become seldom used and commonly regarded as obsolete, thereby effecting a broader reform of the framework.

SCOPE

In-Scope Entities

The New Insolvency Law applies to the following entities:

- Commercial company types with legal personality including, among others:
    - (i) Public companies limited by shares (*société anonyme*);
    - (ii) Corporate partnerships limited by shares (*société en commandite par actions*);
    - (iii) Private limited liability companies (*société à responsabilité limitée*); and

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(iv) Common limited partnerships (*société en commandite simple*); and

- Special limited partnerships (*société en commandite spéciale*), akin to the LLP used under common law.

Out-of-Scope Entities

The New Insolvency Law does not impact regulated entities subject to special insolvency regimes, including, in particular:

- Credit institutions and investment firms;
- Insurance and reinsurance undertakings;
- Payment institutions and electronic money institutions;
- Securitization undertakings issuing financial instruments to the public on a continuous basis; or
- Investment funds (e.g., UCITs, SICARs, RAIFs, SIFs).

OUT-OF-COURT REORGANISATION BY MUTUAL AGREEMENT

Under the New Insolvency Law, a distressed company may, on a voluntary basis, request the appointment of a conciliator (*conciliateur d'enterprise*) named by the minister for the economy or the minister for small and medium-sized enterprises (depending on their competency) for the purpose of facilitating the conclusion of an amicable reorganisation of some or all of the company's assets or businesses with either all of its creditors or at least two of them (an Amicable Agreement).

If an Amicable Agreement is reached, the distressed company may apply for the agreement's certification by the district court sitting in commercial matters (*Tribunal d'arrondissement siégeant en matière commerciale*). Such certification will grant an enforceable character to the Amicable Agreement and make any transactions contemplated by the Amicable Agreement unavoidable, even if they fall – should the distressed company ultimately file for bankruptcy – within the suspect period (that is, the period between the actual date of cessation of payments[1] and the starting date of any eventual bankruptcy proceeding). Prior to the court's certification of an Amicable Agreement, it will verify that the purpose of that Amicable Agreement is indeed to reorganise all or part of the distressed company's assets or activities. A certified Amical

[1] As a general rule, this date may be no more than six months prior to the opening of bankruptcy proceedings.

Agreement is neither subject to publication or notification nor is it, as an out-of-court agreement, subject to appeal.

The instrument of an Amicable Agreement can provide a forum for confidential negotiations between the debtor and its creditors and prepare a pre-negotiated plan of reorganisation. Even if no consensus is reached, this process can help to build the majority required to achieve a court-recognised collective agreement.

JUDICIAL BANKRUPTCY PREVENTION PROCEDURES

As an alternative to the out-of-court reorganisation, a distressed company may seek to preserve the continuity of all or part of its assets or activities under the supervision of the court via a new toolkit of judicial reorganisation proceedings. These tools consist of:

- A Court-Recognised Collective Agreement

  A distressed company may wish to reach a collective agreement (*accord collectif*) with some or all of its creditors on a reorganisation plan. A reorganisation plan that properly depicts the company's current financial situation and lays out its proposed solutions may be submitted to the court for judicial recognition. Participation in this process is limited to ordinary and extraordinary creditors[2] whose rights are implicated by the considered plan.

  Approval of a reorganisation plan is required from a majority of the participating creditors of each class who represent at least half of the sums owed in each class. A mechanism has nevertheless been introduced for approval of the plan by the court despite failure to receive acceptance from a majority of creditors: a reorganisation plan may be approved by the court if:

  The plan has been approved by at least one class of creditors entitled to participate;

  No class is entitled to receive or keep more than the total amount of its claims; and

[2] The New Insolvency Law distinguishes between "ordinary creditors" (*créanciers sursitaires 'ordinaires'*) and "extraordinary creditors" (*créanciers sursitaires 'extraordinaires'*)for the purposes of a court-recognized collective agreement, extraordinary creditors consisting of those holding extraordinary claims, i.e., claims secured by special leins or mortgages, the claims of creditor-owners, and the outstanding claims of tax and social security authorities, while ordinary creditors are those holding ordinary claims, which are simply claims not qualifying as extraordinary claims.

In the case of approval by ordinary creditors only, the plan is built to ensure the favourable treatment of extraordinary creditors.

An approved reorganisation plan, which must be implemented within five years of its approval, will bind all affected creditors, including any dissenting creditors, and the full scope of the debtor's liabilities covered by the plan will be considered fulfilled upon the plan's completion. Even after approval, however, a reorganisation plan may be revoked upon a debtor's declaration of bankruptcy, or at the request of a creditor who has suffered prejudice as the result of the debtor's demonstrable inability to implement the plan. Revocation, though nullifying any future effect of the plan, does not affect the plan's validity concerning payments and transactions already carried out pursuant thereto.

Finally, the creation of a collective agreement on a reorganisation plan is underpinned by a key guiding principle: no creditor should be disadvantaged by the approval of a plan, as opposed to the creditor's treatment in the event that the plan had been rejected and the normal sequence of events (i.e., bankruptcy or compelled liquidation) had played out.

- A Court-Ordered Stay Of Payments

As a distressed company pursues a solution to its financial situation, whether in court or through extrajudicial Amicable Agreement, it may petition the court for a temporary stay (*sursis*) of payments on its debts to buy time for the negotiations of an Amicable Agreement. A temporary stay of this kind may not exceed an initial term of four months (which can be extended to a maximum of 12 months). During the term of the stay of payments:

(i) The debtor may not be declared bankrupt, other than at the debtor's election;

(ii) The movable and immovable assets of the debtor (subject to some exceptions, as is discussed in Section 4 below) are exempted from any enforcement action; and

(iii) The debtor's ongoing contracts are unaffected.

An approved stay of payments affords the debtor the opportunity (and obligation) to prepare for its future viability by preparing a restructuring plan which must include descriptive, prescriptive, and operative elements.

Upon court approval of a stay of payments, the debtor may unilaterally decide to suspend the performance of its contractual obligations during the term of the stay, though (i) the parties with which the debtor has contracted are entitled to the same right, and (ii) the stay does not extend to claims arising from services performed during the stay under ongoing contracts. During the term of the stay, payments from third parties which are required for the continuation of the debtor's business will remain effective.

- A Court-Ordered Transfer of Assets

  At a distressed company's election or by the initiative of the public prosecutor,[3] the court may be petitioned to order the transfer of some or all of the distressed company's assets. The transfer process is overseen by a court-appointed legal representative, who either (i) effectuates the sale or transfer of assets, both movable and immovable, necessary or useful to carry out all or part of the debtor's business by seeking offers from third-party buyers, either publicly or by mutual agreement, or (ii) by seeking offers for a merger. In either event, the legal representative is responsible for presenting the distressed company and the court with the offers received. Judicial approval of the legal representative's selected offer must be granted before the transfer may take place.

  A debtor seeking to avail itself of one of these tools has to submit a petition to the court:

  (i) Describing the facts on which the request is made and upon which, in the company's view, the continuity of its business is threatened;

  (ii) Indicating the objective(s) for which it requests the initiation of the given procedure; and

  (iii) Providing a list of documentation required for the application's assessment[4] or, in the case that any requested documents

[3] Prosecutor is responsible for prosecuting criminal cases and representing the interests of society in litigation.

[4] This documentation is to comprise:
(i) The last two approved annual accounts or the last two personal income tax returns (in the case of natural persons);
(ii) A statement of assets and liabilities and an income statement, each no more than three months old;
(iii) A budget containing an estimate of income and expenditure during the expected timespan of the proceedings;

cannot be provided, a note giving detailed reasons for the impossibility.

While an application for any of the forms of judicial reorganisation is pending, the debtor may not be declared bankrupt nor be judicially dissolved. Finally, no realisation of property, movable or immovable, may take place before the court has ruled on any such petition.

It should be noted that the New Insolvency Law provides for a high level of flexibility in the employment of these proceedings, permitting them to be applied for and eventually employed according to varying strategies for each of a company's businesses or parts of businesses, as well as to petition the court, at any point during a temporary stay of payments, for a change in the objective of the judicial reorganisation procedure.

NO IMPACT ON FINANCIAL COLLATERAL ARRANGEMENTS AND PROFESSIONAL PAYMENT GUARANTEES

The law of August 5, 2005, on financial collateral arrangements, as amended, and the law of July 10, 2020, on professional payment guarantees have positioned Luxembourg as an attractive and creditor-friendly jurisdiction for cross-border transactions.

Financial collateral arrangements (such as pledge agreements or netting arrangements) have always been unaffected by any kind of (national or foreign) insolvency proceedings. Likewise, unless agreed otherwise between the parties, a professional payment guarantee remains in place, despite any kind of (national or foreign) insolvency proceedings opened against the debtor in favour of which the payment guarantee is given.

The New Insolvency Law maintains the safe-harbour rules for financial collateral arrangements and professional payment guarantees so that no procedure under the New Insolvency Law affects in any way the validity or

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(iv) A complete list of the company's creditors and of the assets subject to security interest or mortgage or owned by a creditor;
(v) A statement of the measures and proposals under consideration for restoring the company's profitability/solvency and satisfying creditors;
(vi) A description of the manner in which the company has fulfilled its legal and contractual obligations to inform and consult employees or their representatives;
(vii) In the case that the company requests suspension of any seizure and sale of immovable property, a copy of the relevant order(s)/writ(s); and
(viii) In the case that the company is a legal entity with at least one partner characterized by unlimited liability, with proof that any such partner has been informed.

enforceability of a financial collateral arrangement or a professional payment guarantee. In particular, a court-ordered temporary stay of payments (as described above) does not prevent a creditor from the enforcement of a financial collateral arrangement governed by Luxembourg law.

To the contrary, other security interests, e.g., pledges which do not constitute financial collateral arrangements and mortgages granted by the debtor will generally be unenforceable through any temporary stay of payments.

INNOVATIONS FOR THE EARLY DETECTION OF FINANCIAL DIFFICULTIES

Endowing the measures introduced by the New Insolvency Law with the greatest preventative effect requires the timely identification of companies having a heightened risk of insolvency. To that end, the New Insolvency Law tasks the minister of the economy and the minister for small and medium-sized enterprises with the collection of information, specific to their respective spheres of responsibility, to be used in the detection of companies in financial difficulties whose likelihood of continuity is doubtful.

To make use of this information for early warning purposes, the New Insolvency Law conceives of a special Evaluation Committee for Businesses in Difficulties (*Cellule d'évaluation des entreprises en difficulté*) which will be comprised of five members designated by the minister of the economy from among the ranks of the VAT Authority (*Administration de l'Enregistrement et des Domaines*), the Direct Tax Administration (*Administration des Contributions Directes*), the Social Security Authority (*Centre Commun de la Sécurité Sociale*) and other main public administrators (the Special Committee).

To aid in the detection of debtors in financial difficulties, the Special Committee is equipped to review:

- A list of debtors who, under certain circumstances, have failed to pay all their social security and VAT obligations;
- Notifications of redundancies for economic reasons;
- Information stored at the National Institute of Statistics and Economic Studies (STATEC);
- The *tableau des protêts* prepared by the registrars (*receveurs de l'enregistrement*); and
- Certain judgments against the debtor.

The Special Committee, whose details of operation will ultimately be set down and governed by a Grand-Ducal Regulation, will serve to assess the appropriateness for an in-scope entity to file for bankruptcy.

STRONGER CHECKS AGAINST ABUSES OF THE BANKRUPTCY FRAMEWORK

The New Insolvency Law amends the bankruptcy provisions of the Luxembourg commercial code and the Luxembourg criminal code with a view towards stronger deterrence of fraudulent bankruptcy filings (*banqueroute frauduleuse*).

First, fraudulent bankruptcy is reclassified from its former status as a crime to an offence (*délit*), which, despite at first glance signalling softness on bankruptcy fraud, is ultimately intended to streamline the prosecution of such incidents.

Second, the scope of the offence of fraudulent bankruptcy (as well as the benign simple bankruptcy (*banqueroute simple*) is now broadened to cover not only the debtor's directors but also its de facto directors.

ANCILLARY REFORM

The New Insolvency Law introduces additional regulations to implement the New Insolvency Law's preventative measures into practice, namely the suspension of the statutory obligation for a distressed company to voluntarily file for bankruptcy,[5] along with the suspension of any realisation of assets pursuant to any general enforcement measure (*voie d'exécution*), from the time of the company's application for a judicial reorganisation up to a point in time determined by the court on a case-by-case basis, along with the empowerment of the public prosecutor to initiate bankruptcy proceedings.

Finally, to declutter Luxembourg's insolvency prevention toolkit, the New Insolvency Law marks the formal repeal of several related proceedings (except for the ongoing proceedings) – composition with creditors (*concordat préventif de la faillite*) and controlled management (*gestion contrôlée*) – which have rarely, if ever, been utilised in practice.

CONCLUSION

Similar to the United States with its Chapter 11 proceedings and the United Kingdom with its restructuring schemes, Luxembourg has now reformed and revamped the range of options available to debtors in financially distressed situations and provides viable alternatives to a bankruptcy.

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[5] The 30 days deadline to file for bankruptcy once the two cumulative conditions of cessation of payments and loss of creditworthiness are met is suspended as long as the judicial reorganisation is ongoing.

Luxembourg thereby joins other EU member states, such as Germany with its so-called StaRUG proceedings,[6] having recently modernised their bankruptcy law framework.

While it remains to be seen to what extent the new toolbox introduced by the New Insolvency Law will be used by the players in the Luxembourg economy, the New Insolvency Law is a welcome and much sought-after development, which should enable Luxembourg to increase its attractiveness for restructurings in a number of different scenarios and should preserve the popularity of the double Luxco structure.

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[6] *Unternehmensstabilisierungs- und -restrukturierungsgesetz* of 22 Dezember 2020 (BGBl. I S. 3256), as amended.