Luxembourg's fight against empty shell companies: out-of-court, but never far from court

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A Luxembourg bill of law creating an administrative dissolution procedure without liquidation, forming part of a long overdue substantial insolvency law reform project, should be approved and implemented in 2022. The draft bill allows for a simplified dissolution of commercial companies that do not have any employees or assets, at the request of the Public Prosecutor in collaboration with the Luxembourg Register of Commerce and Companies. This article refers to the version of the draft bill of law as of 31 January 2022.

Luxembourg insolvency laws are currently undergoing a material overhaul as proposed by the draft bill 6539 on the preservation of undertakings and modernising bankruptcy law (*Projet de loi relative à la préservation des entreprises et portant modernisation du droit de la faillite*). The draft bankruptcy bill, filed in February 2013, is still, however, subject to material comments and changes. Luxembourg law governing bankruptcy and insolvency proceedings are genuinely considered outdated, but a vote on this draft bill by the Luxembourg Chamber of Deputies is not yet foreseeable. A less controversial chapter of this draft bankruptcy bill was therefore split and remodelled as a new draft bill 6539B, creating the administrative dissolution procedure without liquidation (*Projet de loi portant création de la procédure de dissolution administrative sans liquidation*) (the 'Draft Bill').

The Draft Bill aims to simplify and accelerate the dissolution of certain commercial companies that have no employees or assets. The first obvious goal is to avoid burdensome, time-consuming and expensive court proceedings to dissolve companies with no material or economic reality. Dissolving empty shell companies, which could be used for criminal purposes should they lack of supervision, is also presented by the Luxembourg legislator as a mission connected with the fight against money laundering and the financing of terrorism. The legislator's intention is to strengthen the continuing trust of foreign states, regulators and stakeholders in Luxembourg as a financial centre and its supporting local industry.

Three cumulative conditions must be met for the administrative dissolution procedure to be initiated at the request of the Public Prosecutor (*Procureur d'État*) against commercial companies:

1. An infringement of criminal law or a material breach of commercial law, including, of course, the law on commercial companies, is a longstanding and usual basis for judicial liquidation proceedings and yet shedding a new light on the powers of the Public Prosecutor in the context of the introduction of this new administrative procedure.
2. The absence of employees is relatively simple and indeed necessary to ensure a speedy process since the presence of employees adds complexities to any insolvency proceedings, with the risk of claims brought before the courts by employees.
3. The absence of assets, for which specific checks will be conducted by the managing entity (the LBR) of the Luxembourg Register of Commerce and Company (*Registre de Commerce et des Sociétés, Luxembourg – RCS*).

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The current judicial liquidation proceedings and the administrative procedure of the Draft Bill pursue the same objectives via different means. However, the sole purpose of the administrative dissolution procedure is to avoid court-ordered liquidation. A comparison between both procedures reveals the main features

and the specificity of the administrative dissolution, in terms of legal prerequisites, powers of the Public Prosecutor, opening of the proceedings, material checks, closing of the dissolution proceedings and judicial recourse.

Prerequisites

Court-ordered liquidations are governed by the law of 10 August 1915 on commercial companies, as amended (the '1915 Law'). Article 1200-1 of the 1915 Law provides that

> 'the District Court (*Tribunal d'arrondissement*) dealing with commercial matters, may order the dissolution and the liquidation of any company governed by Luxembourg law which pursues activities contrary to criminal law or which seriously contravenes the provisions of the Commercial Code or the laws governing commercial companies including those laws governing authorisations to do business'.

The Draft Bill creating the out-of-court administrative procedure specifically refers to article 1200-1 of the 1915 Law as the first condition of an administrative dissolution. Its scope is wide: leaving aside any obvious criminal activities, the lack of filing of annual accounts within the legal timeframe alone is considered a serious breach of the 1915 Law and may give rise, inter alia, to the judicial liquidation of a company pursuant to article 1200-1 of the 1915 Law.

The Public Prosecutor is in charge of identifying the relevant companies, it being noted that the Draft Bill carves out from its scope a list of specific entities such as banks, regulated entities of the financial sector (except for support entities, as they do not exercise a financial activity themselves), insurance and reinsurance companies and law firms, these being deemed subject to their own rules on professional conduct and disciplinary supervision. This key role of identification is supported by any information the Public Prosecutor may automatically receive or request from the following institutions:

- As part of its operational and supervision function, the LBR shall provide the Public Prosecutor with a list of companies that seriously contravene to the laws applicable to commercial companies. This assessment is based on prima facie failure to file information required by law, but also more specifically on an assessment of the documents filed with the RCS (absence of registered office, resignation of the entire board of managers, expired mandates of directors or auditor without replacement, etc).
- The National Institute for Statistic and Economic Studies as part of its ongoing analysis, archiving and preservation duties of annual accounts of companies, which are sent to the Institute by the RCS.
- The tax administration, being noted that by the time the dissolution or liquidation proceedings are opened, the tax administration likely will have requested recovery of debts.

New powers of the Public Prosecutor

The Draft Bill expressly provides that '*precise and concurring information*' outlining that a commercial company meets the conditions of article 1200-1 of the 1915 Law shall exist for the Public Prosecutor to request the opening of the administrative procedure. This specific reference is interesting as it clarifies the powers of the Public Prosecutor. It reminds us about one essential function of the Public Prosecutor, which is to bring a case and supporting evidence to court, but not to take any final decision or judgment. The law would apply exactly the same way without requiring 'precise and concurring information' to prove a case, which should remain the minimum assumption, failing which the Public Prosecutor would obviously exceed its powers. In a judicial procedure, it is the duty of the court to establish its decision based on the evidence brought by the prosecutor that the conditions of article 1200-1 of the 1915 Law are met.

This specific (yet unnecessary) requirement also emphasises that the assessment of an infringement to criminal law or serious breach of commercial laws, as purely factual it might sometimes appear, is anything but straightforward. Is this deemed to limit the powers of the Public Prosecutor by compelling it to diligently accomplish its duties? It can reasonably be assumed that the supposed prudent position of the legislator does not in any way limit the powers or duties of the Public Prosecutor to conduct its assessment freely.

Opening of the proceedings

Both decisions to request the opening of the existing judicial procedure and the opening of an administrative procedure under the Draft Bill strictly remain at the entire and sole discretion of the Public Prosecutor. The opening of the administrative dissolution procedure may not be requested by a third party, creditor or shareholder. The company shall not have any right to initiate or request the opening of such proceedings.

Technically, the administrative proceedings are open within three days of the request by a decision of the LBR. The decision is then notified to the company and published on the Luxembourg central electronic platform for official publications (*Recueil* électronique *des sociétés et associations – RESA*) within three days of the date of the LBR's decision.

Following the publication date of the RESA's decision, the company is prevented from managing and employing its assets as if it was declared bankrupt by a commercial court. Article 444 of the Luxembourg Commercial Code applies and any payment made by the company or to the company and any operation or action made by it are void.

Administrative dissolution proceedings are conducted based on the assumption that the company has absolutely no activity. However, the apparent lack of activity or assets does not mean that there is no creditor. The sanction is a severe and critical decision for creditors, which are left out of the picture. The consequences are even more controversial, in that the actual material checks on the absence of assets and employees are to be carried out specifically after the publication of the decision to open the procedure.

Material checks

Following fair criticism and instances of formal opposition issued by the Council of State (*Conseil d'Etat*) in 2013, 2018 and 2021, material checks on the absence of assets and employees were added and tightened in the Draft Bill, which refers to '*verifications*', in the sense of a confirmation of a first assessment made by the Public Prosecutor. The sequencing laid out in the Draft Bill bears the risk of serious contradictions. The assumption of the absence of employees and assets will generally be made on the basis of annual accounts, but what if the serious breach of company law (the first condition) is actually the lack of filing of the latest annual accounts? The 'verifications' to be made post publication of the opening of the dissolution proceedings are essentially a compromise introduced to benefit creditors' rights, even though the LBR may have carried out preliminary checks before putting the relevant company on the list submitted to the Public Prosecutor in view of the opening of administrative dissolution proceedings.

The administrative dissolution procedure is not directly affected by the existence of debts. Therefore, the company to be dissolved is at no point referred to as a debtor in the Draft Bill. The Prosecutor and the LBR do not need to assume the company has no debt, only that it has no assets. The LBR shall nevertheless be in charge of searching for assets (again, not for creditors). This is an interesting but obviously burdensome matter. In a judicial liquidation procedure, a liquidator – often a lawyer in Luxembourg – is appointed and their role is to settle due and payable liabilities and realise assets, for example by requesting the payment of claims owed to the company and by paying debts owed by the company. In a similar way, the LBR will proceed to very specific searches listed in the Draft Bill. It shall enquire about the existence of assets registered in the company's name from seven types of institution: the main retail banks registered and operating in Luxembourg (*banques de guichet implantées au Grand-Duché de Luxembourg*); the main insurers companies operating in Luxembourg; the Luxembourg (*Bureaux des Hypothèques*) registering mortgages; the Land Registry and Topography Administration; the National Society of Automotive Traffic (should vehicles be registered in the company's name); the local tax administration of the last known registered office; and the social security institution.

Further to criticism from the Council of State, the reference to 'the main banks registered and operating in Luxembourg' and 'the main insurers companies operating in Luxembourg' have been replaced by 'banks' and 'non-life insurers'. The most recent version of the Draft Bill also provides for the possibility for the LBR to request the Luxembourg Supervisory Authority for the financial sector (*Commission de surveillance du secteur financier – CSSF*) to provide any IBAN number of the relevant company in Luxembourg. In the (likely) absence of reply from these entities within a one-month period, the LBR shall resume the dissolution proceedings.

Regarding the conditions of the absence of employees and assets, the risk of litigation can never be ruled out. An administrative procedure, the main purpose of which is to establish the absence of assets, would therefore be unsuitable, especially if the 'verifications' listed in the Draft Bill are limited to employees working in, and assets located in, Luxembourg. However, during the judicial recourse proceedings (see below), it would then be up to the plaintiff to prove that the company had either employees or assets. Even if successful, the company would not necessarily be relieved as it may still face proceedings for judicial dissolution and liquidation to be initiated by the Public Prosecutor.

The LBR's capacities in terms of organisation and workforce could be heavily challenged. The costs borne by the LBR shall be reimbursed by the state, not out of the assets that may have been discovered during the searches. The LBR will of course only proceed with the searches listed in the Draft Bill and material checks will be limited to assets and employees based in Luxembourg. A pragmatic compromise, which undoubtedly demonstrates some limits in an international financial place such as Luxembourg.

Closing of the dissolution procedure

The LBR shall inform the Public Prosecutor of the results of its searches, which are verifications of the Public Prosecutor's own assessment. From there,

two options exist. First, should any asset be identified, the cumulative conditions for an administrative dissolution are not met and the Public Prosecutor will request the LBR to stop the administrative dissolution proceedings; a concurring decision shall be published by the RESA. Second, all material conditions are confirmed, the Public Prosecutor shall request the LBR to pursue the administrative dissolution proceedings, which may (the Draft Bill are unclear) be materialised by a decision closing the proceedings and leading to the dissolution without liquidation of the company.

The Draft Bill provides that the administrative dissolution proceedings shall be closed at the latest six months following the opening decision. The closing decision, to be published at the RESA, automatically leads to the dissolution of the company. It should be noted that the failure to close the administrative dissolution within that timeframe is simply not sanctioned by any measure provided for in the Draft Bill.

Judicial recourse

The opening decision published at the RESA shall set out the reasons for the opening of the administrative dissolution procedure without liquidation and inform that any recourse be addressed to the President of the District Court dealing with commercial matters within one month following the date of publication. There is no reference at all to proceedings relating to the filing of claims held against the company.

The relevant company and any third party with an interest (including, of course, potential creditors) may file a claim or lodge an appeal, as applicable, which shall be served to the Public Prosecutor and the LBR respectively. The claimant may (but must not specifically) provide evidence that one or several conditions for the administrative dissolution open against the company were not correctly assessed. The administrative proceedings shall to the extent possible remain out of court and it is as such revealing that the right of recourse offered by the Draft Bill only refers to the opening decision, not the closing decision leading to the dissolution, at a point in time where the actual material checks cannot yet have been fully conducted by the LBR.

The President of the District Court dealing with commercial matters may revoke the opening decision if all the cumulative conditions are not deemed to be met. Should an infringement of criminal law or serious breach of commercial laws pursuant to article 1200-1 of the 1915 Law be confirmed, the company shall be brought in view of the opening of a judicial liquidation procedure.

Conclusion

The draft bill 6539B aims to create an administrative dissolution procedure without liquidation, inspired in the main by existing legal and practical tools used in common dissolution or liquidation proceedings, adjusted to provide Luxembourg with an efficient weapon to remove empty shell companies without economic reality. It is fair to say that bringing a case to court and requesting the managing entity of the register of trade and companies to open administrative dissolution proceedings is not exactly the same in terms of separation of powers. Administrative dissolution proceedings will therefore remain under the supervision of Luxembourg courts dealing with commercial matters. Therefore, the implementation of the administrative dissolution procedure might not really result in such a gain in terms of time and effort.

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