The new landscape for Luxembourg insolvency procedures

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The Law on the Preservation of Enterprises and Modernising Bankruptcy Law dated 7 August 2023 came into force on 1 November 2023. The Law reshaped the Luxembourg insolvency regime by introducing a true alternative to bankruptcy into Luxembourg law, with new procedures for out-of-court arrangements and judicial reorganisations for companies facing financial difficulties.

Introduction

The introduction of the Luxembourg law of 7 August 2023, known as 'the Law on the Preservation of Enterprises and Modernising Bankruptcy Law' (the 'Law of 7 August 2023' or the 'Law') marks a significant shift in the approach to insolvency proceedings in Luxembourg.

This legislation emerges against a background of urgent need for reform, to create a more adaptable, flexible and preventive legal framework to manage business distress and insolvency. Its enactment is a response to both domestic imperatives and European Union directives, notably the implementation of the directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, debt forgiveness and discharges, and on measures to be taken to increase the effectiveness of restructuring procedures, insolvency and the remission of debts, and amending directive (EU) 2017/1132 (the 'Restructuring Directive').

Historically, the insolvency regime in Luxembourg was mainly composed of bankruptcy proceedings (*faillite*), and the existing alternatives such as controlled management and preventive composition with creditors were rarely used. This approach often led to the premature liquidation of potentially viable businesses, a practice not in line with the demands of a dynamic economy and the financial environment in Luxembourg.

At the heart of this legislative reform is a dual focus on prevention and recovery. The Law of 7 August 2023 introduces early warning systems aimed at detecting financial distress at an early stage, thereby enabling timely intervention. Additionally, the Law sets the stage for both judicial and extrajudicial reorganisation processes that offer distressed businesses a spectrum of options that take into account the difficulties faced.

One of the major aspects of the Law of 7 August 2023 is the emphasis on creditors' engagement and protection. By creating a system of early detection of financial difficulties and facilitating creditors' involvement in the restructuring process, the Law ensures that creditors are not passive bystanders but active participants in shaping the outcome. This framework not only enhances the likelihood of business continuity but also aims at improving the recovery rate for creditors.

In essence, the Law of 7 August 2023 is about more than just modernising bankruptcy law; it is about redefining the landscape of business failure and recovery. As Luxembourg navigates the complexities of a globalised economy, the Law of 7 August 2023 is proof of its adaptive legislative environment. It reflects a deep understanding of the challenges faced by businesses in the current context and offers a robust framework for managing insolvency that balances the needs of all stakeholders. In doing so, it not only enhances Luxembourg's competitiveness as a financial hub but also contributes to a more stable and dynamic economic future.

To provide an overview of the new landscape of the Luxembourg insolvency procedures, this article will outline the available procedures from the stages of early detection, the flexibility and discretion of out-of-court arrangements, the comprehensive approach of judicial reorganisation, and the last resort: bankruptcy.

Alarm mechanisms and early detection

The Law of 7 August 2023 addresses alarm mechanisms and early detection of financial distress. By doing so, it introduces an innovative and preventive framework aimed at safeguarding the economic health of businesses before reaching the point of insolvency. This aspect of the Law is designed to identify, at an early stage, companies that are facing financial difficulties, thereby enabling interventions that could prevent full-blown insolvency proceedings.

The key components of the alarm mechanism include data collection and analysis of specific data points that may indicate a company is experiencing financial stress. This includes information on economic layoffs, unpaid social security contributions and outstanding tax debts. The collected data serves as an early warning system, alerting authorities to potential issues that could jeopardise the company's future.

This data is provided to the Minister for the Economy and the Minister for the Middle Classes, who are responsible for identifying businesses that are in distress based on the data received. Their identification triggers a series of potential interventions designed to assist these businesses.

Upon identification of a distressed company, the relevant member of government can convene the company in order to discuss the financial difficulties it is facing and explore solutions available to the company to remedy such difficulties. This direct intervention aims at providing businesses with the knowledge and resources they need to proactively address their financial issues.

Moreover, the Law also provides for the possible appointment of a conciliator (*conciliateur d'entreprises*) by the Minister for the Economy or the Minister for the Middle Classes. The conciliator assists the debtor in its reorganisation efforts, which can be executed through out-of-court arrangements or judicial reorganisations. Additionally, in cases of serious breaches that threaten the continuity of a business, a court-appointed agent (*mandataire de justice*) can be appointed. The purpose of this agent is to implement measures aimed at preserving the continuity of the business, with the initiative for this appointment potentially coming from any interested party.

The mission of the conciliator or the court-appointed agent concludes either upon the request of the debtor or the appointed official, ensuring that the support provided is both purposeful and timely.

Out-of-court arrangements: flexibility and discretion

Out-of-court arrangements relating to amicable agreement (*accord amiable*) in the Law of 7 August 2023 offer a strategic opportunity for commercial entities, businesspersons and civil companies to reorganise their financial and operational structures outside the formal legal scope.

This procedure, aligned with the principles of the alarm mechanisms, is designed to ease the restructuring of a debtor's assets or business activities through agreements with at least two creditors, without the spectre of public scrutiny or the procedural complexities of court proceedings. A significant advantage of this arrangement is its resilience in the face of bankruptcy. Indeed, transactions made under the scope of the out-of-court arrangement remain unaffected even if the debtor subsequently enters bankruptcy (although their execution is suspended by the opening of bankruptcy proceedings), ensuring that creditors engaged in an out-of-court arrangement are shielded from any liability for not preserving the business' continuity.

The discreet nature of this procedure is critical to allow for the reorganisation efforts to remain confidential, with the potential for court homologation to confer legal enforceability upon the arrangement. This discretion provides a protective veil for the debtor's business reputation and operational continuity. Moreover, the involvement of a conciliator, appointed at the debtor's request, can extend the support beyond the mere agreement formation to help with the successful implementation of the out-of-court arrangement, offering guidance through the reorganisation process.

To initiate an out-of-court arrangement, the debtor must satisfy minimal conditions. At least two creditors must be involved in the reorganisation plan that aims at restructuring part or all of the debtor's operations or assets. Once the arrangement is reached, the court, ruling on the debtor's request, homologates the arrangement after verifying that it has been concluded with the aim to reorganise the business of the debtor. This decision cannot be appealed.

This homologation ensures the legitimacy and enforceability of the out-of-court arrangement, marking an important step towards the financial rehabilitation of the debtor.

Judicial reorganisation: a comprehensive approach

In the Law of 7 August 2023, the judicial reorganisation procedure stands as a pivotal mechanism, providing a structured path for businesses in distress to recover and stabilise without resorting to bankruptcy. The judicial reorganisation procedure is designed to be inclusive, applicable to commercial entities, individual entrepreneurs, and civil companies alike, ensuring stability for the Luxembourg economy.

The judicial reorganisation proceedings can be opened at the request only of the debtor as soon as its business is jeopardised to pursue one of the three following objectives: (i) enable an out-of-court arrangement; (ii) obtain a collective agreement of creditors on a reorganisation plan; or (iii) enable a transfer by court order. The objective may vary for different segments of the business and may be changed at the debtor's request.

*The standstill (*sursis*) and the opening of a judicial reorganisation*

The initiation of a judicial reorganisation triggers a crucial suspensive effect, immediately shielding the distressed entity from bankruptcy declarations, liquidation or dissolution, and halting the execution against its property. This protective measure is the first step in a series of meticulously outlined procedures aimed at facilitating the recovery of businesses through reorganisation.

The first advantage of this procedure is that the petition itself has a suspensive effect even before the court rules on the opening or not of the proceedings. This means the debtor cannot be declared bankrupt, the companies cannot be subject to judicial liquidation or administrative dissolution without liquidation, and no realisation of movable or immovable property of the debtor is possible.

The standstill may be requested to (i) enable an out-of-court arrangement to be reached; (ii) obtain a collective agreement of creditors on a reorganisation plan; or (iii) enable any part of the assets or business of the distressed debtor to be transferred by court order.

An important consequence of the standstill is the possibility for the debtor to opt unilaterally for the suspension of the execution of its contractual obligations if imperatively required in the course of the reorganisation. Consequently, the creditor could also decide to stop executing its own obligations without the agreement being terminated.

It will no longer be possible to accelerate the underlying debt or terminate the underlying agreements. However, it is worth mentioning that pledges and financial collateral granted under the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (the 'Financial Collateral Law') can be enforced as long as the enforcement is not conditional exclusively upon the acceleration of the underlying debt owed by a Luxembourg borrower. Pledgees can enforce their security subject to the Financial Collateral Law on the ground of other enforcement events such as a cross-default, a breach of covenant or any other events as agreed between the parties even though the secured obligations are not due and payable.

An extension of the standstill is possible at the request of the debtor or the court-appointed agent in the case of transfer proceedings by court order, and based on the report of the appointed judge (*juge délégué*).

The petition for judicial reorganisation is submitted by the distressed debtor to the court and Article 13 of the Law requires the submission of detailed documentation upon filing for judicial reorganisation. This includes, among others, financial statements, a list of creditors, proposed recovery measures, and a clear indication of the reorganisation objective as listed above.

The debtor shall also provide an indication of the class of creditors. Indeed, claims shall be classified as claims subject to a standstill (*créances sursitaires*) which are claims (other than salary claims) arising prior to the judgment opening the judicial reorganisation proceedings or arising as a result of the filing of the petition or decisions taken in connection with the judicial reorganisation proceedings or claims not subject to a standstill (*créances non-sursitaires*) which are all the other claims.

The claims subject to a standstill can, in turn, be classified as extraordinary (claims subject to a standstill and secured by a special lien or mortgage, claims of owner-creditors and claims subject to a standstill of tax and social security authorities) and ordinary (all the other claims subject to standstill).

The court then examines the petition within 15 days of its filing and issues a ruling within eight days of examining the petition. If the petition is accepted, the court:

- sets the standstill at a maximum of four months (which may be extended); and
- designates the place and date of the hearing at which the vote on the collective agreement will take place (if the aim of the proceedings is to obtain a collective agreement).

*Collective agreement (*accord collectif*) in judicial reorganisation proceedings*

Article 39 of the Law foresees that once the judicial reorganisation proceedings have commenced, the

debtor shall notify the creditors within 14 days of the amount of the claims and their classes.

This first phase is crucial as it will lead to the determination of the amount of the claims and the categorisation of each claim either as an ordinary or extraordinary claim.

The debtor initially proposes an amount and a category, and the creditor may accept this proposal or remain silent, in which case the claim will be admitted according to the debtor's proposal.

If the creditor disagrees, such creditor will bring the dispute to the debtor's attention. Unfortunately, as Article 40, paragraph 1 of the Law does not provide any further details on how this objection is to be made, it is recommended to submit any objections to the debtor by registered mail. This contestation then opens a phase of amicable discussions. However, in the event of a persistent disagreement, the creditor must refer the matter to the court that initiated the reorganisation procedure.

The Law does not set a deadline for challenging the qualification of a claim but it is clearly in the creditor's interest to do so as soon as possible, in order to be able to take part in the vote on the reorganisation plan.

In addition, the debtor shall prepare and file a reorganisation plan with the court at least 20 days before the hearing to decide on a collective agreement set in the judgment opening the judicial reorganisation. Articles 42 to 47 of the Law provide the detailed framework for the content of the reorganisation plan which must include, among others, proposals for addressing creditors' claims, which may include payment extensions, debt relief, conversion of debt into equity and other debt restructuring measures.

After notification of the reorganisation plan by the debtor to the creditors, the plan is then put to a vote at a designated court hearing, requiring approval from a majority of creditors in each class of claims. This voting process is critical, as it engages creditors directly in the decision-making process, allowing them to have a say in the business' future direction.

Within 15 days of the hearing (and, in any event, before the end of the standstill), the court shall decide whether or not the plan is homologated. The court may homologate the plan even if the majority of creditors did not vote in favour thereof. The court reviews the plan to ensure it meets all legal requirements and it is in the best interest of all parties involved. The court evaluates the proposed financing arrangements, the fairness of the plan to creditors and the overall feasibility of the plan in preventing bankruptcy.

If homologated, the plan is notified by the court registry to the debtor and its creditors and published in the Luxembourg electronic platform of companies and associations (RESA). This step is vital, as it formalises the restructuring efforts and sets the stage for the implementation of the reorganisation plan. Indeed, the homologation of the plan makes it binding on all creditors whose claims are subject to a standstill.

The implementation of the reorganisation plan is closely monitored by appointed officials that oversee the execution of the plan, ensuring that the debtor adheres to the agreed-upon measures and timelines. The successful implementation of the plan is crucial for the company's recovery, requiring diligent execution and cooperation from all stakeholders.

If, despite the implementation of the reorganisation plan, the debtor is declared bankrupt, the plan is automatically revoked and a creditor may request the revocation of the plan if the debtor is evidently not in a position to execute it and the creditor suffers a damage as a consequence thereof.

This revocation means that, except for payments already made, the plan is invalidated, and the debtor and creditors revert to their original positions before the plan's approval. This provision underscores the plan's significance as a tool for avoiding bankruptcy and highlights the consequences of failing to achieve the plan's objectives.

*Transfer by court order (*transfert sous autorité de justice*) in judicial reorganisation proceedings*

The judicial reorganisation by the transfer by court order aims at preserving, under the control of the court, the continuity of all or part of the company's assets or activities. Such transfer can be (i) requested by the debtor (in its petition for judicial reorganisation or during the course of the judicial reorganisation proceedings); or (ii) ordered by the Public Prosecutor or by a creditor or any person interested in acquiring all or part of the business.

A court-appointed agent (*mandataire de justice*) is automatically appointed and its appointment is published in the RESA. The role of the court-appointed agent is to organise and carry out the transfer or assignment of the movable or immovable assets that are necessary or useful to maintain all or part of the economic activity. The transfer can take the form of a merger. The scope of the transfer is set either by the court or is left to the discretion of the court-appointed agent, who will have a fairly heavy burden in determining the viability of the business or part of the business or activities to be transferred. A court will not have the necessary knowledge and experience to do so.

The court-appointed agent draws up one or more concomitant or successive transfer projects to be notified to the appointed judge (*juge délégué*) and to the

debtor at least two days before the hearing, at which the agent asks the court for authorisation to proceed with the proposed transfer(s). If approved, the transfer(s) is/are carried out by the court-appointed agent.

Bankruptcy as a last resort

Reaffirming bankruptcy as a last resort underlines the Law's overarching goal to avoid liquidation where possible. By making bankruptcy a last-resort procedure reserved for instances where recovery and restructuring efforts are unfeasible, it ensures that all possible solutions for saving a distressed business are explored before resorting to liquidation.

Although the bankruptcy proceedings already existed, the Law of 7 August 2023 introduces new elements to such bankruptcy proceedings that are outlined below.

As was the case previously, bankruptcy is declared when a debtor fails to meet two crucial criteria: (i) the inability to pay its debts as they become due; and (ii) the loss of its creditworthiness. The debtor must file for bankruptcy within a month after the debtor becomes unable to pay its debts as they come due. However, one of the novelties of the Law is that this obligation to declare bankruptcy is suspended from the moment the petition for judicial reorganisation is filed and lasts until the standstill expires.

Under the revised Article 442 of Luxembourg's Code of Commerce, bankruptcy is declared by the court pursuant to the admission by the debtor, the petition of its creditor, and by the request of the Public Prosecutor or by the court on its own initiative once it has received information on the financial difficulties of the debtor. However, the court will not declare the bankruptcy until it has convened the debtor and heard the debtor's situation. The appeal against the judgment of declaration of bankruptcy shall be made within 40 days (previously 15 days).

Upon declaring bankruptcy, the court will determine the date of the debtor's cessation of payments. This date cannot be set more than six months prior to the judgment opening the bankruptcy proceedings. Without a specific determination, cessation of payments is presumed from the date of the bankruptcy declaration.

The creditors must then declare their claims within the timeframe set by the bankruptcy declaration judgment, typically six months from the declaration date (the declaration period may be subject to extensions). The creditors are required to provide documentation supporting their claims. This includes detailing the nature of the claim, the amount owed and any security attached to the claim.

A novelty of the Law is also the introduction of a debt discharge mechanism. Indeed, by the introduction of a new article 536-3 in the Code of Commerce, the Law allows that an insolvent debtor (an individual) may benefit from a discharge by the court from the balance of claims arising prior to the bankruptcy judgment, without prejudice to any security given by the insolvent debtor or a third party. Such discharge may only be granted by the court at the insolvent debtor's request. However, if the debtor is guilty of serious and established misconduct that has contributed to the bankruptcy, or has provided inaccurate information at the time of the filing for bankruptcy or subsequently to requests made by the supervisory judge or the receiver, the court will refuse to grant the requested discharge. The main purpose of this provision is to allow individuals to be discharged from remaining debts post-bankruptcy, aiming to provide them with a fresh start.

Additionally, and without analysing the relevant provisions in detail, the Law addresses the liabilities of the companies' managers or directors (as applicable), establishing clear consequences for those found guilty of mismanagement or contributing to the company's inability to pay debts (*cessation de paiement*) without substantial changes. It also outlines the potential personal bankruptcy for those abusing the corporate structure for personal interest.

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