Modernisation of Luxembourg's insolvency law

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Luxembourg has modernised its insolvency system through the long-awaited adoption of rules on business preservation. The new insolvency law completes the reform launched in October 2022 with the administrative dissolution without liquidation procedure. This article explains that the new law is of major importance because it introduces restructuring schemes, either out-of-court or judicial, which, although present in the old framework, were hardly ever used. This is the first time Luxembourg has adopted tools to detect distressed businesses, offering measures to give the business a second chance instead of filing for bankruptcy.

Introduction

Luxembourg has introduced a long-awaited reform of the insolvency discipline with new preventive measures to detect situations of economic financial distress. The measures included in the reform offer businesses an opportunity to avoid bankruptcy and generally modernise the country's insolvency toolbox. With this reform, Luxembourg aims to offer a second chance to entrepreneurs and companies experiencing a period of difficulty, to preserve the continuity of their business.

Historically, bankruptcy has been viewed as a negative phenomenon with occasionally severe consequences, such as loss of certain civil rights and consequences on the future of the bankrupt individual. However, this perception has evolved recently under the Anglo-Saxon influence, where bankruptcy is seen as part of the normal life of an entrepreneur or a company owner, who can be granted a second chance under certain circumstances.

Until 19 July 2023, Luxembourg's existing bankruptcy discipline was mainly enshrined in the Napoleon-inspired Commercial Code introduced on 15 September 1807, which dealt with insolvency (*faillite*) and bankruptcy (*banqueroute*). While several amendments have been introduced, no thorough structural reform of the system has ever been made. The Luxembourg approach to bankruptcy is based on the assumption that a trader (*commerçant*) is insolvent when it 'no longer has the ability to pay its debts and has lost its creditworthiness with its creditors' (*cession des paiements et ébranlement du credit*). The Luxembourg system did not provide for any intermediate solution to a distressed financial situation; instead, like a plague, it had to be eradicated through bankruptcy procedures and final destruction of the business.

Only three solutions were provided for corporate restructuring plans. However, these solutions were very rarely used, and lately not at all, as they were regarded as unsuitable for modern requirements. The three solutions were: (1) the *concordat préventif de la faillite* (law of 14 April 1886); (2) the *sursis de paiement* (law of 1934); and (3) the *gestion controlee* (*arrêt grand-ducal* of 24 May 1935).

With the various and severe crises lately experienced, several countries have decided to move towards a restructuring discipline for companies in financial distress, which aim to safeguard them rather than definitively annihilate them. Although there has been discussion of reforming the insolvency and bankruptcy system in Luxembourg since 2011, with a first Bill of Law of 2013, only in 2023 was the insolvency and bankruptcy law finally overhauled, introducing measures to preserve businesses and modernise the insolvency and bankruptcy system itself.

An acceleration of the modernisation of the insolvency and bankruptcy system has also been endorsed by the European Union, which has legislated extensively on the subject, up to the most recent Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 20219 on preventive restructuring frameworks, discharge of debt and disqualifications, measures

to increase the efficiency of procedures concerning restructuring and discharge of debt, and amendments to Directive (EU) 2017/1132 (Directive on restructuring and insolvency) (the 'Directive').

The Directive imposed an obligation on Member States to implement a more attractive and flexible restructuring scheme in their national systems for companies in financial distress that may lead to a state of insolvency. Despite the initial deadline of 17 July 2021, many Member States, including Luxembourg, requested an extension. On 19 July 2023, Luxembourg finally voted in favour of the new law concerning the business preservation and modernisation of insolvency law (the 'insolvency law'[1]), which aims at complying with the Directive.

The context of the Directive

The Directive aims to contribute to the proper functioning of the internal market and remove obstacles to the exercise of fundamental freedoms, such as the free movement of capital and freedom of establishment, which result from differences between national laws and procedures concerning preventive restructuring, insolvency, debt relief and debarment. Thus, the Directive aims to offer a second chance to companies and entrepreneurs in financial difficulty through effective national preventive restructuring measures that allow them to continue to carry out their business.

Moreover, the Directive is also a reaction to the frequent forum shopping experienced by European companies in financial difficulties that have sought remedies under the English restructuring schemes.

As mentioned above, a deadline had been imposed on Member States to implement the Directive at national level. While few intrepid countries met the deadline (Germany and the Netherlands), other Member States are slowly adopting the new measures in restructuring schemes.

The context of the new insolvency law

The Luxembourg project of the law (PL6539; hereinafter the 'Bill of Law') on business preservation and modernisation of the insolvency law has been split into two bills:

- PL6539A, concerning the reorganisation of the companies; and
- PL6539B, which led to the Law of 28 October 2022, creating the administrative dissolution procedure without liquidation, already effective from 1 February 2023.

The purpose of the Bill of Law involved four main aspects: (1) preventive; (2) restorative; (3) repressive; and (4) social.

With regard to the preventive aspect, the newly adopted insolvency law aims to prevent a company in financial difficulty from being declared bankrupt by creating appropriate mechanisms to encourage entrepreneurs to apply for support measures promptly and preventively. For this reason, conservative measures have now been created and are detailed below.

The restorative aspect aims to provide unfortunate, but still *bona fide*, debtors with a second chance. This includes the possibility, as an entrepreneur, of no longer being liable for the balance of the bankruptcy debts after its closure, and to extend such situation to the reorganisation procedure.

The repressive angle advocates decriminalising fraudulent bankruptcy (from *crime* to *délit*) to facilitate the prosecution process and prevent those involved in bad faith from leaving their unfortunate business and engaging in a new one. Also, the administrative dissolution procedure without liquidation was introduced in October 2022 to dissolve companies that are almost without assets, and that would lead the state to bear the liquidation costs.

Finally, the social aspect seeks to preserve the business and the employment generated by it.

The new insolvency law

The long-awaited Bill 6539A was officially adopted on 21 July 2023 and published in the *Journal Officiel* on 7 August 2023. The insolvency law will enter into force on 1 November 2023.

The new insolvency law introduces different innovations, including a system to detect the warning signs of a distressed business via a new screening body and three new preventive reorganisation schemes: conciliation, reorganisation by mutual agreement by a voluntary out-of-court arrangement and judicial reorganisation proceedings.

The rationale underpinning the insolvency reform is the willingness to offer a second chance to entrepreneurs and companies which may encounter, in good faith, a period of economic and financial hurdles in the normal course of business, to continue their undertaking through an agreement with creditors, instead of being forced to file for bankruptcy and close down the whole operation.

Preventive measures to detect financial or economic distress

The recent reform of the insolvency law also introduced a preventive tool of control for companies in financial difficulties and likely to be declared bankrupt.

The Minister of the Economy and the Minister of Small and Medium-Sized Enterprises are responsible for identifying debtors in difficulty. The insolvency law provides the relevant ministries with several indicators relevant to identifying potential symptoms of economic distress, including annual accounts, redundancies for economic reasons and debts with public authorities.

The insolvency law introduces a new, dedicated, public agency, the Cellule d'évaluation des entreprises en difficulté, created to assess the appropriateness of bankruptcy petitions.

Three tools to restructure a business in Luxembourg

Under the conciliation procedure, the debtor may apply to the Ministry of the Economy or the Ministry for Small and Medium-Sized Enterprises to appoint a *conciliateur d'entreprise*. The *conciliateur d'entreprise* has the task of facilitating the reorganisation of all or part of the debtor's assets or business.

The out-of-court arrangement (*accord amiable*) provides for a dialogue between the debtor and the creditors (at least two) under the possible, but not mandatory, supervision of a conciliator. Once an agreement has been reached, the debtor shall apply to the court for approval. The court has a supervisory function to verify that the reorganisation can be effective on all or part of the assets or business. Once approved by the court, the arrangement becomes enforceable. A peculiar but key feature of this arrangement is that in the event that the reorganisation is not sufficient to revive the business, such arrangement will not be subject to potential clawback actions in the event of a subsequent bankruptcy. This would also apply to the judicial restructuring schemes.

The purpose of the judicial reorganisation proceedings is to preserve, under the supervision of a judge, the continuity of all or part of the company's assets or business. There are three type of judicial reorganisation proceedings:

- *Sursis* is the tool by which the debtor seeks a stay to reach a mutual agreement with creditors, which is regulated by the out-of-court rules set out above, with the common rule provided for the judicial reorganisation proceedings described below.
- *Accord collectif*, whereby the debtor seeks a collective agreement with certain creditors on the grounds of a reorganisational plan for a period of up to five years.
- *Transfert par decision de justice* provides for a court order to transfer all or part of the assets or the business to one or several third parties.

The requirements for the application of these judicial reorganisation proceedings are common. They include: the debtor's application when it considers that the continuity of its activity is threatened shortly or in the long term; delegation of a judge from the debtor's application; information to the public prosecutor; a stay (*sursis*) for up to four months; suspension of the time limit to file for bankruptcy (one month) for the time of the aforementioned *sursis*; suspension of any bankruptcy, judicial liquidation or enforcement measure (with exceptions) decision until the court's decision on the debtor's application is issued; payments effective against third parties; and an enforceable exiting financial arrangement or agreements.

The court examines the application in the following 15 days. The debtor is summoned to be heard in chambers (*chambre du conseil*), but may waive the right to be heard. Should the court consider that the conditions are fulfilled, it renders the judgment in the eight days following the examination of the case.

The judicial reorganisation procedure remains a voluntary procedure of the debtor, who may also put an early end to it. It is worth mentioning that the court may terminate the restructuring procedure when the debtor is unable to ensure the continuity of all or part of its assets identified in the restructuring plan. At the same time as declaring the proceedings closed, the court may declare bankruptcy or, in case of a corporation, judicial liquidation, should the relevant conditions be fulfilled.

In the case of a collective agreement, the debtor must submit to the court the reorganisation plan at least 20 days before the scheduled hearing. In this procedure there is also a responsibility of the creditor, since the debtor is obliged to inform the creditor of the amount of its claim, and the latter may contest that amount. If no objection is made one month prior to the hearing, the creditor will only be considered for the amount specified by debtor's notice.

An additional novelty of this restructuring measure is the *ex novo* introduction of the cross-claim cram down mechanism, widely known and developed in the United Kingdom, allowing dissenting classes of creditors to be forced to restructure under a plan approved by the majority of the members of each class.

It is worth noting that creditors benefiting from financial collateral arrangements (eg, pledges), set-off or netting arrangements, and professional payment guarantees should be unaffected by the judicial reorganisation proceedings and should be able to enforce their guarantees.

The final restructuring measure is the judicial transfer of all or part of the company or its activities to a third party to ensure the continuity of the business. This measure may be consented to by the debtor in its application for judicial reorganisation or during the proceedings itself if, for example, the application for reorganisation is rejected by the

court or the reorganisation plan is not accepted by the creditors.

When ordering the transfer, a court-appointed agent (*mandataire de justice*) from among the sworn experts list is tasked with carrying out the transfer. If there are employees, the representatives (if any) or the employees themselves will be consulted.

Conclusion

In conclusion, together with the first reform introduced in 2022 with the administrative dissolution without liquidation measure, Luxembourg is innovating its insolvency system by creating the possibility of safeguarding a business, and at the same time satisfying creditors who until now had no other remedy than applying for bankruptcy.

With such reform, Luxembourg increases its attractiveness and competitiveness in restructuring practices that were, until now, almost absent. For the time being, practitioners will be able to test the extent of the innovative tools introduced, and the impacts should be tangible in the next few years.

Notes

1 Journal Officiel du Grand-Duché de Luxembourg, https://legilux.public.lu/eli/etat/leg/loi/2023/08/07/a521/jo, accessed 17 October 2023.

About the authors

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