Client Alert

7 November 2023

Luxembourg: Insolvency law reform

From 1 November 2023, a reality in Luxembourg

In brief

On 1 November 2023, the Luxembourg law dated 7 August 2023, issued from Draft Bill No. 6539A on business preservation and modernization of the insolvency law ("**Law**" or "**Reform**"), entered into force.

While initial discussions leading to this Reform started about ten years ago[1], the need for suitable instruments to address financial difficulties in businesses was further emphasized by the pandemic, resulting in a notable increase in bankruptcies in Luxembourg since 2021.

The long-awaited Reform therefore aims to prioritize company reorganizations over liquidation and to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt.

By adopting the Law, the Luxembourg legislator's goal is to substantially modernize the Luxembourg insolvency framework and namely the restructuring mechanisms (i.e., the composition with creditors (concordat préventif de la faillite), controlled management (gestion contrôlée), moratorium or reprieve from payment (sursis de paiement) proceedings, which, over time, have become inadequate for current business' requirements.

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To achieve that purpose, the Law:

- Provides for two types of reorganization procedures: (i) one extra-judicial (by mutual agreement) and (ii) one judicial (either by mutual agreement, by collective agreement, or by transfer by court order), which replace the outdated procedures of composition with creditors, controlled management and reprieve from payment.
- Modernizes the provisions of the Commercial Code and of the Criminal Code on bankruptcy proceedings to mainly codify practical use developed over the years.
- Grants a second chance to entrepreneurs, notably in implementing the restructuring frameworks directive EU 2019/1023 ("**Restructuring Directive**").

The Law has the following two purposes:

- To identify distressed debtors at an early stage.
- To introduce new and efficient reorganization procedures in Luxembourg's framework to debtors facing a distressed situation.

To preserve Luxembourg's creditor-friendly orientation and the related effectiveness of the Luxembourg law dated 5 August 2005 on financial collateral arrangements, as amended ("**2005 Law**"), it is worth noting that the enforcement of financial collateral arrangements falling within the scope of the 2005 Law is not affected by the Reform and remains possible during the judicial reorganization procedure despite the stay pronounced by the court.

[1] Draft bill No. 6539 was first introduced on 1 February 2013 and then split into two bills in 2021: 6539A, discussed in this alert, which was designed to modernize bankruptcy law, and 6539B, which resulted in the Luxembourg law of 28 October 2022 creating a procedure for administrative dissolution without liquidation.

As the Reform represents a significant shift in Luxembourg's insolvency law, this alert seeks to outline the main features of Luxembourg's new insolvency legal framework.

For further information on what these developments mean for your organization, please get in touch with your usual Baker McKenzie contact.

Scope of the Law

1. The Law applies to the following debtors:
    - Traders and craftspeople.
    - Commercial companies (e.g., S.A., S.à r.l., S.C.A, S.C.S.).
    - Special limited partnerships.
    - Civil companies.
2. The Law does not apply to the following entities, which are subject to special insolvency regimes:
    - Credit institutions and investment firms.
    - Payment institutions and electronic money institutions.
    - Insurance and reinsurance companies.
    - Luxembourg UCITS and other undertakings for collective investments subject to a Luxembourg sectoral law (SIF, SICAR, RAIF).
    - Pension funds.
    - Securitization vehicles.

Detection mechanisms for businesses facing difficulty and likely to be declared bankrupt

The Reform introduces new measures to detect distressed businesses at an early stage.

The minister's intervention

The minister in charge of the economy and the minister in charge of small and medium-sized enterprises are responsible, within their respective areas of responsibility, for detecting debtors facing financial difficulties when these difficulties are likely to jeopardize the continuity of the debtor's business.

To detect debtors facing difficulties, the competent minister may notably access the following information:

- Information held by the National Institute of Statistics and Economic Studies (Institut national de la statistique et des études économiques or — STATEC).
- Certain judgments against the debtor.
- Annual financial statements filed and published.
- Notifications of dismissals for economic reasons.
- The list of debtors who have not paid all social security and VAT debts, as well as wage and salary deductions within three months, and who have been subject to an administrative constraint

The competent minister may also invite the debtor to provide any relevant information on the state of its business and inform it about the available preventive and reorganization measures.

The new Cellule d'évaluation des entreprises en difficultés

To boost the detection of the businesses likely to be declared bankrupt, the Law creates a special evaluation committee called "Cellule d'évaluation des entreprises en difficultés" for businesses facing difficulties. This evaluation committee is responsible for assessing the appropriateness of bankruptcy summons from state creditors.

New reorganization procedures

Following the Reform, distressed businesses will have access to a range of extra-judicial or judicial reorganization options.

Extra-judicial reorganization procedure

The debtor may propose to all or at least two of its creditors to conclude a mutual agreement for the reorganization of its assets or activities.

Once the debtor and its creditors have reached an agreement, the debtor will apply to the court to have the agreement approved. The court will assess whether the purpose of the agreement is to reorganize (in whole or in part) the debtor's assets or activities before granting the homologation that will make the mutual agreement enforceable.

If the debtor declares bankruptcy despite the homologated mutual agreement, the transactions made within the arrangement will not be canceled.

Depending on what the debtor decides, such agreement may or may not be confidential.

Judicial reorganization procedures — common features

Following the Reform, if its business is jeopardized, either in the short or the longer term, and even if its situation already qualifies as bankruptcy, the debtor may initiate a judicial reorganization procedure. In its application to the court, the debtor must, among other things, provide evidence of its situation and indicate what is/are the objective(s) for which it requests the opening of a judicial reorganization procedure.

The aim of this procedure is to preserve, under the supervision of a judge, the continuity of the business's activity and assets.

Objective pursued

The procedure can be opened to pursue any of the following objectives:

- Securing a stay of proceedings with a view to reaching a mutual agreement.
- Agreeing on a reorganization plan with the creditors.
- Allowing the transfer, by court order, to one or more third parties of all or part of the debtor's assets or activities.

Effects of the submission of the application[2]

The Law states that from the instant the debtor files its application for a judicial reorganization procedure until the court rules on it, the following applies:

- The debtor may not be declared bankrupt (except at its own initiative) nor judicially dissolved, nor be subject to an administrative dissolution procedure without liquidation.
- No enforcement action may be taken against the debtor's movable or immovable assets during the stay of enforcement (subject to the exceptions indicated below).
- The debtor is under no obligation to file bankruptcy.
- Ongoing contracts continue to apply under their existing terms of execution.

[2] Articles 18 and 30 (1) of the Law and Article 440 of the Commercial Code.

Opening of the procedure

The judicial reorganization is opened by a decision of the district court within 23 days of the filing of the request if the debtor's business is threatened in the short or long term.

Effects of the opening of the judicial reorganization procedure[3]

- The duration of the stay on proceedings applying as of the debtor's application for a judicial reorganization procedure is set by the court: this period can initially be fixed for a maximum of four months but can be extended, by court order procedure, up to a maximum of 12 months from the date of the court's judgment.
- No enforcement of claims may be pursued or exercised against the debtor's assets.
- The debtor may not be declared bankrupt (except at its own initiative) nor judicially dissolved, nor be subject to administrative dissolution procedure without liquidation.
- No seizure may be carried out.
- The debtor is under no obligation to file bankruptcy.
- Payments remain enforceable towards third parties if the payment is necessary for the continuation of the business.
- Ongoing contracts continue to apply under their existing terms of execution. However, the debtor may unilaterally decide to suspend the performance of its contractual obligations (except with respect to employment contracts) for the duration of the stay of proceedings by notifying its co-contractor(s) of this decision when the reorganization of the company imperatively requires it. In return, the co-contractor(s) may suspend the execution of their own contractual obligations.
- Claims relating to services provided to the debtor during the judicial reorganization procedure, whether resulting from new commitments of the debtor or existing contracts at the time of the procedure's opening, are considered debts of the estate in a bankruptcy or liquidation, provided that there is a close link between the end of the judicial reorganization procedure and this collective procedure.
- A court-appointed agent or a provisional administrator may be designated.

However, the following are not subject to the stay of proceedings:[4]

  - Financial collateral arrangements (e.g., pledges), set-off, or netting agreements — falling under the 2005 Law — remain enforceable.
  - Claims arising from ongoing contracts with continuing performance (contrats à prestations successives) (including contractually payable interest), to the extent that they relate to services carried out after the judgment opening the judicial reorganization procedure.
  - Co-debtors and personal security grantors (that exclusion is justified by the negative effects that an exemption would have on the debtor's own credit).

At any time during the stay on proceedings, the debtor may ask the court to modify the judicial reorganization procedure's objective or to withdraw its request in whole or in part.[5]

If it becomes evident that the distressed debtor can no longer guarantee business continuity or has submitted inaccurate or incomplete information with its court's application, the judicial reorganization procedure can be terminated ahead of schedule.

The actions undertaken during or as a result of the reorganization procedure are not subject to the hardening period in case of the subsequent bankruptcy of the debtor.

[3] Articles 22, 23, 25, 26, 27, 29, 30, 32 of the Law and Article 440 of the Commercial Code.

[4] Articles 28, 29 and 31 of the Law.

[5] Articles 34 and 35 of the Law.

Decisions to approve or reject an application for a judicial reorganization procedure are subject to appeal through an expedited process, but parties are not allowed to request their setting aside (or opposition).

The conciliation

Whether outside or as part of a judicial reorganization procedure, the debtor may ask the competent minister to appoint a company's conciliator to facilitate the reorganization of all or part of its assets or activities.

The conciliator's mission is to prepare and facilitate either (i) the conclusion and execution of a mutual agreement, (ii) the creditors' agreement to the reorganization plan, or (iii) the transfer, by means of a court decision to one or more third parties, of all or part of the debtor's assets or activities.

The mission of the conciliator does not necessarily terminate with the opening of a judicial reorganization procedure.

Second chance mechanisms

The Reform implements the provisions of the Restructuring Directive. One of the major ideas of the Restructuring Directive is to promote "new chances" to no longer stigmatize failure and to grant an honest manager who has gone bankrupt a new opportunity to do business.

To achieve that purpose, the following second chance rules were introduced by the Reform. They should be read in conjunction with the new chance provisions introduced by the reform on the right of establishment, allowing an entrepreneur who faced bankruptcy to obtain, under certain conditions, a new business license.

Introduction of a discharge of debt regime for the natural persons

The Law introduces a discharge of debt regime for natural persons who have been declared bankrupt. The bankrupt natural persons and their personal guarantors may apply for a discharge of their debts that arose prior to the bankruptcy judgment. However, in the case of fraud or serious misconduct (faute grave et caractérisée), the discharge of debt will not be granted.

At the request of the bankrupt natural person, he/she may be discharged by the court from the balance of claims arising prior to the declaration of bankruptcy. This request must be added to the admission of bankruptcy or filed before the bankruptcy is declared or within one month of the bankruptcy being declared if the bankruptcy is declared less than six months after it was opened.

The court clerk will notify the receiver (curateur) of this request. The court will rule on the request for cancellation within 18 months of publication of the bankruptcy judgment.

Any interested party, including the receiver and the public prosecutor (procureur d'Etat), may, by petition notified to the bankrupt by the court clerk, from the date of publication of the bankruptcy judgment, request that the write-off be granted only in part, or refused in its entirety by reasoned decision, if the debtor has committed serious and proven faults, which have contributed to the bankruptcy, or if the debtor has knowingly provided inaccurate information on the occasion of the admission of bankruptcy.

Decriminalization of fraudulent bankruptcy

Fraudulent bankruptcy is no longer considered a crime but constitutes an offense (délit). Prosecution is thus facilitated.

Extension of the offenses of both simple bankruptcy and fraudulent bankruptcy to the debtor's de jure or de facto managers

For the court to impose a ban on carrying on commercial activity, the bankrupt or de jure or de facto managers must have "contributed to the bankruptcy."

Modernization of the bankruptcy regime

In addition to the repeal of the outdated procedures of composition with creditors, controlled management, and reprieve from payment, a series of other noteworthy provisions are amended in the Commercial Code and in the Criminal Code.

Suspension of the obligation to file an admission of bankruptcy within one month

Should an application for a judicial reorganization procedure be filed, the one-month time limit for the directors of a Luxembourg company to declare the inability of the company to pay its debts as they fall due (cessation des paiements) will be suspended until the expiry of the stay of proceedings as determined by the court.

Legal authority granted to the public prosecutor to initiate bankruptcy proceedings

The Law gives the public prosecutor the legal authority to initiate the bankruptcy procedure.

A 40-day time period to appeal bankruptcy judgments and fixed-date oral proceedings

The time limit to appeal against a bankruptcy judgment is extended from 15 to 40 days. As for the appeal procedure, the Law stipulates that a writ of summons must be served on a fixed date and that the appeal will be dealt with promptly using the oral procedure.

Claims declaration

The period to file proof of claims has been extended to six months from the date of the bankruptcy judgment.

The new provisions of the text stipulate that the court may relieve the claimant of the foreclosure, on written request, if they can justify moral or material circumstances that prevented them from submitting their claim declaration in good time, in accordance with the provisions of the amended law of 22 December 1986 relating to the relief of forfeiture, resulting from the expiration of a time limit for taking legal action.

Creditors are required to notify the bankruptcy receivers of any change of address. Failing to do so will mean that summons are deemed validly served to the last address communicated to the receivers.

Publication of the bankruptcy judgment in foreign newspapers

The court may also order that the bankruptcy judgment be published by an extract in foreign newspapers.

Third-party accounts

The reference to the "Caisse des consignations" has been removed, and sums collected by the receiver are paid into a third-party account specially opened in the name of the bankruptcy. The receiver is required to provide the official receiver (juge-commissaire) with an extract from the third-party account at the beginning of each calendar year, as well as on request.

In the case of sufficient assets, the receiver may request that the official receiver grant them an advance on the costs of the bankruptcy proceedings out of the assets collected.

Communication with the bankrupt

The communication with the bankrupt, as well as summons, will be done through either a registered letter, fax, email, or any other means of communication.

Verifications of annual accounts and financial statements

The receivers may request the bankrupt's assistance in closing and ending the books and records and may call on the assistance of an accountant or expert accountant.

Abolition of the inventory estimate

The bankruptcy receiver's obligation to estimate the value of inventory items has been removed.

Deadline for submitting the bankruptcy status report to the official receiver

In the event of bankruptcy, the receiver has six weeks to submit to the official receiver a summary report on the apparent state of the bankruptcy (main causes, circumstances, and characteristics). The receiver must also respond to any bankruptcy-related inquiries from the public prosecutor within a period of three months.

Debates on contestation

The receiver has 15 days from the verification of the claim to inform the creditor of its declaration being contested. The creditor then has 40 days to request a contestation debate.

Closure of bankruptcy proceedings in the case of insufficient assets

If, at the earliest, six months from the date of the bankruptcy judgment, it is acknowledged that the debtor's assets are insufficient to cover the presumed costs of administering and liquidating the bankruptcy, the court may, based on the official receiver's report, pronounce, even ex officio, the closure of the bankruptcy operations.

Actions against receivers

Actions against receivers are time-barred after five years from the date of the bankruptcy judgment.

Assets discovered once the company's bankruptcy has been terminated

If assets emerge after the bankruptcy is closed, the court may revoke the decision to close the bankruptcy.

Contact Us

Jean-François Trapp
Partner
jean-francois.trapp
@bakermckenzie.com

Annie Elfassi
Partner
annie.elfassi
@bakermckenzie.com

Laurent Fessmann
Partner
laurent.fessmann
@bakermckenzie.com