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Modernization of the Luxembourg Insolvency Law

Introduction of the judicial reorganization

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New Luxembourg law to preserve businesses and modernize insolvency law – What to expect?

Part 1 - Presentation of the changes brought by a long-awaited reform

The Law of 7 August 2023 on businesses preservation and modernization of bankruptcy law (the "**Law**") will come into force on 1st November 2023. On 19 July 2023, the Luxembourg parliament finally adopted the related draft bill, after more than a decade since the first draft bill (n° 6539) was presented.

The most recent law relating to insolvency matters (namely on controlled management) dated back to 1935 and the EU Commission had pressed Luxembourg to comply with the Directive (EU) 2019/1023 of the European Parliament and of the Council, of 20 June 2019, on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt. This new Law was therefore long-awaited.

The law establishes two types of reorganization procedures: reorganization by amicable collective agreement and judicial reorganization. The latter entails a stay of execution and can be carried out either by amicable agreement, by adopting a plan or through a court-ordered transfer.

To qualify for these reorganization procedures, companies and enterprises facing financial difficulties must be identified. The law introduces new measures to detect such situations, with new duties for the Economy Minister and the Middle Classes Minister and the creation of an assessment unit ("*Cellule d'Evaluation des entreprises en difficulté"*) to evaluate the suitability of bankruptcy petitions for public entities or administrations.

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The law covers four aspects: prevention, recovery, sanction, and social aspects.

On the prevention side, the law provides companies with new tools of reorganization, tailored to their size, to enable business continuity.

- The recovery aspect gives a second chance to unfortunate but honest companies and enterprises.
- The sanction aspect, while appearing less severe on fraudulent cases, actually facilitates the prosecution of fraudulent cases and bad faith debtors.
- Finally, the social aspect is addressed by the new reorganization procedures, which would preserve activities and thus employment.

The impact of this new Law, and especially the new reorganization procedures, on companies remains to be seen.

The Law aims to prevent bankruptcy by facilitating the recovery and continuity of viable businesses through a reform of the legal framework. It replaces the outdated procedures of controlled management and composition with creditors with two new proceedings, i.e. reorganization by amicable agreement (“*réorganisation par accord amiable”*) and judicial reorganization procedure (“*réorganisation judiciaire”*), which enables companies and some entities (special limited partnerships, commercial or civil companies, individual traders and craftsmen, with certain exceptions such as credit institutions, investments firms, financial institutions, electronic money institutions and payment institutions, insurance and reinsurance undertakings, etc.) in situation of imminent or foreseeable peril (the "**Debtor**") to preserve all or part of their assets or activities under judicial supervision.

The amicable agreement is a voluntary out-of-court proceeding whereby the Debtor and at least two of its creditors mutually agree to reorganize all or part of the assets or the business of the Debtor. Once obtained, the district court can validate the agreement upon request of the Debtor.

For judicial reorganization, the Debtor can choose one of the following objectives by submitting a petition with supporting documents to the district court:

To obtain a stay to negotiate an amicable agreement with some of its creditors.

To obtain the creditors' consent on a reorganization plan to reach a collective agreement with some of its creditors. The stay allows the Debtor to set up a plan that details the measures to restore the business viability.

To enable the court-ordered transfer of all or part of the Debtor’s assets or of its activities to one or more third parties, which can be initiated either by the Debtor or by the State public prosecutor.

From the submission of the judicial reorganization’s petition, no bankruptcy, judicial liquidation, administrative dissolution without liquidation or enforcement measures, with exceptions, can be declared or taken until the judgment of the district court ruling on the Debtor's request. The district court examines the petition within fifteen days and checks whether the opening conditions are met, especially whether the business is in imminent or foreseeable peril, and whether the request is not abusive or fraudulent. If so, the district court opens the judicial reorganization procedure and appoints a supervisory judge to monitor it. The district court can also appoint a judicial representative to assist the Debtor in its reorganization, if requested and useful.

The opening of the procedure starts the stay on payments, which cannot exceed four months, with possible extensions up to a total maximum of 12 months. Subject to certain exceptions and to applicable contractual provisions, ongoing contracts will continue. If the reorganization requires it, the suspension of the enforcement of certain agreements is possible with certain exceptions. Financial collateral arrangements falling within the scope of the amended Law of 5 August 2005 remain enforceable and unaffected by a judicial reorganization procedure. Payments remain enforceable against third parties. The Debtor can request the district court to change the objective of the judicial reorganization procedure at any time during the stay.

The judicial reorganization procedure can be closed by a district court's decision, either by the early termination of the procedure, at the Debtor's request or on the supervisory judge's report, if the opening conditions are no longer met or if the Debtor fails to comply with its obligations. The end of the judicial reorganization procedure results in the end of the stay and the resumption of the creditors' rights and actions unless the approval or closure judgment provides for specific provisions.

The main stages of the judicial reorganization by collective agreement
Among the measures designed to ensure the continuity of businesses, the Law introduces a procedure of judicial reorganization by collective agreement. It aims at obtaining the agreement of creditors with non-wage claims (the "Creditors") on a plan elaborated by the Debtor.

Communication to Creditors

Within 14 days of the district court order initiating the judicial reorganization procedure, the Debtor must inform the Creditors of the amount and nature of their debts, as well as the class they belong (i.e., ordinary or extraordinary Creditor). Any Creditors or third parties claiming to be Creditors may file a protest if they dispute this.

The plan

The Debtor prepares the plan during the stay (up to 4 months) granted by the district court when it opens the judicial reorganization procedure. It has two parts:

(1)A descriptive part that gives the Debtor's identity, its economic situation, the cause of its difficulties and how to overcome them, the different categories of debts, their value, a statement explaining why the plan offers a realistic chance of avoiding the Debtor's insolvency, etc.
(2)A prescriptive part that sets out measures to pay off the Creditors and, if applicable, the duration of the proposed restructuring measures.

As a general rule, the plan must be prepared by respecting the principle that Creditors in the same category of claims must be treated equally and in proportion to the amount of their debtsclaims, as well as meeting the best interest of the Creditors by not putting them in a worse position than they would be without a plan (e.g., if the normal order of priorities were applied in the case of bankruptcy or liquidation),

The reorganization plan must precisely describe the rights of the Creditors and how they can be modified following the vote and approval of the plan. More generally, it may also contain an assessment of the consequences that its approval could have for the Creditors.

When applicable, the Debtor has the possibility to mention the transfer of all or part of its assets or activities in the plan.

Moreover, a list of Creditors having only minimal claims may also be provided in it alongside a justification stating why it is in the best interest of the rest of the Creditors that those claims be dealt with outside the plan and liquidated immediately.

The plan cannot provide for a period of implementation longer than 5 years and must be submitted by the Debtor at least 20 days before the hearing described below.

The hearing
At the hearing, the district court hears to the report of the delegated judge, the Debtor and the Creditors. The plan is deemed approved if it gets a positive vote from the majority of Creditors in each class, who represent by their debtsclaims half of the total principal owned. It should be noted that Creditors not participating in the vote and their claims are excluded from the calculation of the majorities.

Approval

It is worth noting that if the majority of the Creditors in each class did not vote in favor of the plan at the previous stage, it may nevertheless be approved on the proposal of the Debtor (or with its agreement) and imposed on the dissenting classes via a cross-class cram-down mechanism, provided certain conditions are met.

More generally, within 15 days of the hearing, the district court decides whether to approve the reorganization plan or not. The plan can be rejected for reasons such as, inter alia, non-compliance with formalities, breach of public order and lack of realistic chance of preventing the Debtor's insolvency or ensuring the viability of the business. The Debtor can appeal against a rejection, and the parties involved in the judicial reorganization procedure can appeal against an approval.

The plan becomes binding on all Creditors when it is approved and this approval ends the judicial reorganization proceeding. The Debtor is fully and permanently released from all debts in the plan when it is implemented. However, this does not apply to co-debtors or individuals who have given a personal security, except in certain cases.

Revocation

The reorganization plan is revoked if the Debtor is declared bankrupt. A Creditor may also request a revocation when the Debtor is clearly no longer able to implement the plan, and the Creditor suffers damage from this lack of implementation.

Such a revocation deprives the plan of all effects, except for transactions and payments made prior to the revocation.

One of the objectives of the judicial reorganization procedure may be to obtain the transfer of all or part of the Debtor’s business or its activities in order to maintain them. This reorganization by court-ordered transfer is initiated by the Debtor, the State public prosecutor, a Creditor or any person having an interest in acquiring all or part of the business.

The judgment ordering the transfer

The judgment ordering the transfer designates a legal representative to organize and complete the transfer in the name and on behalf of the Debtor. In this judgment, the court may order an additional stay (not exceeding six months) which has the effect, inter alia, that the Debtor's movable and immovable property cannot not be subject to any enforcement proceedings in respect of non-wage claims during this period.

The effect of employment contracts on the transfer

If the Debtor has employees, the rights and obligations resulting for the Debtor (transferor) from the employment contracts existing at the time of the transfer of its business are transferred to the transferee.

The Debtor or the legal representative must inform the prospective transferee in writing of all obligations relating to the employees concerned by the transfer and of all pending actions brought by the employees against their employer. Fulfilling this obligation is crucial because the transferee cannot be bound by any obligations other than those communicated in this way in writing.

The transferee, the transferor or the legal representative must apply to the labor court for approval of the planned transfer, insofar as the transfer agreement has an impact on employees.

Organization of the transfer

The legal representative organizes and carries out the court-ordered transfer either by:

- selling or transferring the movable or immovable assets necessary or useful for maintaining all or part of the Debtor’s economic activity
- organizing a merger

As part of this process, one or more sale projects are prepared by the legal representative and communicated to the delegated judge appointed at the very beginning of the reorganization procedure. Then, by request notified to the Debtor, the legal representative seeks court authorization to proceed with the proposed sale. In this respect, it should be noted that no offer (or modification of an existing one) made after this request can be taken into consideration by the court.

Court authorization for transfer

Following the report of the delegated judge, the court grants the requested authorization if the sale ensures that all or part of the Debtor’s business is maintained and that the rights of the Creditors are respected.

An appeal may be lodged against the judgement authorizing the sale within eight days of its notification. In any case, an extract of this judgment is published in the electronic register of companies and associations.

The sale must take place in accordance with the sale project authorized by the court and the rights of the Creditors are transferred to the sale price.

Termination of the judicial reorganization procedure

When the legal representative considers that all the activities likely to be transferred have been transferred, and in any event before the end of the stay, he or she requests the court to terminate the judicial reorganization procedure. In this case, the court hears the Debtor and rules following the report of the delegated judge.

The decision to close the judicial reorganization procedure is published in the electronic register of companies and associations. This decision discharges the transferee from all obligations other than those mentioned in the transfer document.

Modernization of insolvency law

The Law also aims to modernize insolvency law. Whereas the Law has mainly been a codification of the practice that was in use by insolvency practitioners and courts, some amendments will be affecting Creditors. The most important of these changes relate to the submission of claims and the procedure for dealing with claims disputes.

As from 1st November 2023, Creditors must file their claims within a period of six months from the date of the insolvency judgement, under penalty of foreclosure. Compared to the previous legislation, this deadline may appear to provide a longer period for filing claims, but in practice, the previous article of the Commercial Code regarding the filing of claims within a shorter period was not strictly applied and Creditors were allowed to file claims after the deadline, almost until the end of the insolvency proceedings. The six-month deadline under penalty of foreclosure, if strictly applied by the courts, will give the insolvency officeholder more predictability in the management of the insolvency proceedings, but less time for Creditors to file.

In the case of disputed claims, unless the claim is a wage claim, it is up to the Creditor whose claim has been disputed by the insolvency officeholder to request the court to hear the case. The insolvency officeholder shall notify each disputed Creditor of the rejection of its claim by registered letter within a period of fifteen days from the date of verification of the claims. From the date of such registered letter, the disputed Creditor will have forty days to file a claim with the commercial court, under penalty of foreclosure. Such a new legal provision will mean a shorter time and a positive action on the part of the disputed Creditors if they do not want to have their claim definitively rejected without being able to present arguments.

On the part of the directors/managers, they are exempted from the obligation to file for insolvency if they have filed for judicial reorganization for the duration of the stay granted by the court.

The articles relating to the extension of the company's insolvency to directors or managers and the measures to bridge insufficient assets remain largely similar to the previous legislation. The last notable change is the abolition of fraudulent bankruptcy *(banqueroute frauduleuse)* in order to facilitate the prosecution of simple bankruptcy cases *(banqueroute simple).*

Judicial reorganization procedure

Overview

Submission of the petition
by the Debtor for the opening of a reorganization procedure

Effects of the submission of the petition

1) Opening of a file at the Court clerk's office
2) Appointment of a supervisory judge by the Court
3) No bankruptcy, judicial liquidation, administrative dissolution without liquidation or enforcement measures (with exceptions)
4) Suspension of the obligation to submit a bankruptcy petition

Judgment
opening the reorganization

Effects of the opening of the reorganization

1) Beginning of the stay (up to 4 months) granted by the Court
2) Continuity of existing contracts (with exceptions)
3) Payments remain enforceable against third parties
4) New debts are considered as claims arising from the insolvency estate
5) Designation of a court-appointed agent or a provisional administrator (optional)

Objectives of the judicial reorganization procedure

Objective n°1
Amicable agreement

The Debtor negotiates with its Creditors (or at least 2 of them) to reorganize all or part of its assets or business

Objective n°2
Collective agreement

Preparation of the reorganization plan by the Debtor

Objective n°3
Court-ordered transfer

Request of the transfer of all or part of the company by the Debtor or the State Prosecutor

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