June 2018

IFLR
INTERNATIONAL FINANCIAL LAW REVIEW

Corporate insolvency & reorganisation Report 2018

Luxembourg

Laurence Jacques and Denis Van Den Bulke, VANDENBULKE

SECTION 1: Market overview

1.1 Please provide a brief overview of your jurisdiction's corporate insolvency and restructuring environment and its versatility in cross-border cases. Are there any significant current concerns/debates taking place in the market?

The 2007 financial turmoil affected a large number of financial institutions with a presence in Luxembourg, leading to an increasing number of insolvency and reorganisation proceedings being opened between 2010 and 2013. In October 2014, the holding companies of Portuguese mixed conglomerate Espirito Santo were all declared bankrupt as a result of the collapse of the second-biggest Portuguese lender Banco Espirito Santo.

Luxembourg was also hit by the Madoff scandal, which affected a substantial number of investment funds in Luxembourg and the cross-border insolvencies of institutions such as Lehman Brothers, Dexia, Fortis, and (former) Icelandic banks (Kaupthing, Landbanski or Glitnir).

After the peak of the insolvencies in 2012 to 2013, the number of bankruptcies declined in 2014 by 20%. In 2017, some 935 companies were declared bankrupt for the whole territory. It is worth mentioning that these bankruptcies mainly cover industrial sectors outside the financial sector which remain very stable.

Luxembourg continues to be an attractive international business location, offering a wide range of investment vehicles that can be used for all types of cross-border restructurings or turnaround purposes.

Laurence Jacques
Partner, VANDENBULKE
Luxembourg
T: +352 2638 3350
F: +352 2638 3349
E: lj@vdblaw.com
W: www.vdblaw.com

About the author

Laurence Jacques is a partner at VANDENBULKE, leading the corporate and insolvency practice. She specialises in corporate and acquisition finance, M&A, domestic and cross-border insolvencies and restructurings, venture capital and private equity.

She is regularly appointed by Luxembourg courts as liquidator for investment funds or financial companies in distress and has been appointed as bankruptcy receiver of listed company Espirito Santo Financial Group, the holding company of the banking arm of Group Espirito Santo.

Laurence has specific experience advising financial institutions, lenders, investors, alternative capital providers, asset-based lenders and private equity funds on borrowings, new lending, restructurings, workouts and enforcements of debt and equity positions. She provides strategic advice in the enforcement process of loans to servicers, sellers of loans and mortgage-backed securities as well as to investors owning or acquiring stressed or distressed assets.

Denis Van Den Bulke
Managing Partner, VANDENBULKE
Luxembourg
T: +352 2638 3350
F: +352 2638 3349
E: dv@vdblaw.com
W: www.vdblaw.com

About the author

Denis Van den Bulke has been the managing partner of VANDENBULKE since 2005. He has more than 25 years of experience in international corporate finance, acquired throughout his career at the UN, World Bank, ING and US firm Dorsey & Whitney (London). One of the originating directors of the Luxembourg Fund Association (ALFI), he also specialises in corporate finance, venture capital, and M&A. He has extensive M&A cross-border experience for Fortune 500 companies.

Approved as liquidator by the Luxembourg Authority Supervising Financial Sector (CSSF), Denis has been entrusted with mandates of the voluntary liquidation of several investment companies in risk capital (SICARs) or specialised investment funds (SIFs) having invested in real estate assets or in financial products as well as unregulated securitisation companies.

1.2 What have been the key recent market trends and/or legal developments in the area that practitioners should be aware of?

The manufacturing and services industries have been the most affected sectors in 2017.

Bankruptcies are generally opened on industrial, trading or service companies whilst the investment fund industry has shown to be pretty stable and is rarely affected by insolvencies, due to the regulator's close supervision.

Luxembourg's so-called bankruptcy remote security packages, in other words financial collateral arrangements governed by the Financial Collateral Law have proven to be a formidable weapon to facilitate out-of-court restructurings under the control of senior creditors. Similarly, Luxembourg courts have been proven to adopt a consistent and pragmatic approach in their interpretation of the Financial Collateral Law, thereby enhancing the attractiveness of such security packages for creditors.

1.3 Please review any major (recent/current) restructuring cases or initiatives that are influencing activity or court decisions regarding insolvency and/or restructuring cases that have set precedents.

Major restructuring cases for group companies are generally organised outside the Luxembourg territory and subject to other legislation. Luxembourg is however a first-choice jurisdiction for creditors willing to secure the restructuring of their debtor's business, thanks to its bankruptcy remote Financial Collateral Law and the courts secular experience of international business restructurings.

SECTION 2: Processes and procedures

2.1 What restructuring and insolvency processes are typically available for financially troubled debtors in your jurisdiction? Do groups of companies receive special treatment?

Luxembourg has two major types of insolvency proceedings: bankruptcy (*faillite*) governed by the Commercial Code (article 437ff) and reorganisation proceedings governed by specific legislation. The insolvency reform contemplates replacing the prevailing reorganisation proceedings.

Most of the insolvency cases opened in Luxembourg are subject to bankruptcy. Bankruptcy aims at repaying creditors through the liquidation of the debtor's assets. Bankruptcy can be initiated by the debtor, its creditors or the court itself. The court will declare a debtor bankrupt upon the cumulative conditions that the debtor: (i) is unable to repay its debts as they fall due; and, (ii) has lost its financial creditworthiness (bankruptcy conditions). As from the opening of the bankruptcy, the existing management is deprived of managing the debtor's assets. The bankruptcy is managed by a court-appointed receiver (*curateur*), whose mission is to realise the debtor's assets and repay the creditors in accordance with their rank. The receiver acts under the supervision of a supervising judge appointed by the court.

Reorganisation proceedings are rarely used in practice and can only be petitioned by the debtor. In the first stage, the court rules on the

global merits of the claim. If the court considers there are sufficient grounds for reorganisation proceedings, it will open a preliminary phase and appoint judges and/or experts to investigate and report on the debtor's state of affairs. After hearing these reports, the court grants or denies the merits of the proceedings.

During reorganisation proceedings, the existing management remains but acts under the court's supervision. Any reorganisation plan requires the creditors' consent (at majorities varying depending on the type of reorganisation proceeding the debtor has petitioned for). Courts may at any time deny or terminate the proceedings and open a bankruptcy if the bankruptcy conditions are met.

Distressed debtors can opt for one of these three types of reorganisation proceedings:

- Controlled management (*gestion contrôlée*): aims at effecting the reorganisation or the orderly liquidation of the debtor's business, under the supervision of one or several court-appointed commissioners. Controlled management is governed by grand-ducal decree of May 24 1935 and can only be initiated by a debtor acting in good faith, who has lost its financial creditworthiness or faces difficulties in meeting all of its financial commitments. Reorganisation or liquidation plans must be set up by the commissioner, approved by a majority (in number) of creditors representing 50% of the debtor's liabilities, before being ratified by the court and further implemented.
- Composition with creditors (*concordat préventif de faillite*) allows a debtor to avoid filing for bankruptcy by entering into an agreement with creditors on the settlement of their claims. In accordance with the law of April 14 1886 on composition with creditors, these proceedings are subject to approval of a majority of creditors representing 75% of the debtor's liabilities. If ratified by the court, the agreement must be implemented by the debtor. Secured creditors who wish to vote in the composition with creditors must waived their security rights.
- Reprieve from payments (*sursis de paiement*) allows a debtor who faces temporary liquidity difficulties to defer its payments until its financial liabilities can be met. The debtor's temporary financial difficulties must be due to extraordinary and unexpected circumstances and its audited balance sheet must demonstrate an excess of assets over liabilities. During the investigation phase, the court has discretion to grant a temporary stay, either immediately or at a later stage in the procedure. The reprieve from payments requires the consent of a majority of creditors representing 75% of the debtor's liabilities and the approval of the Luxembourg Superior Court of Justice.

The recast 2015 Regulation on insolvency proceedings entered into force in June 2017 and provides for new rules regarding the cooperation and communication between insolvency practitioners in the frame of insolvencies affecting several companies of a same group. In Luxembourg, there is no specific regime applying to group companies, which are treated as individual and separate bankruptcies.

2.2 What is the impact on creditors of a formal filing? Are contractual termination rights affected? Are security or individual enforcement actions stayed?

The opening of a bankruptcy automatically and immediately suspends all legal proceedings against the debtor and prevents any creditors' enforcement actions.

The appointment of a judge by the court to investigate the debtor's state of affairs triggers an automatic stay under the controlled management procedure. Unsecured creditors are similarly prevented from taking enforcement actions against a debtor which has filed for composition with creditors as from the day on which the court appoints the investigative judge. The reprieve from payment procedure allows the court to grant a temporary stay during the investigation phase. The final admission by the court of the reprieve from payment has the effect of preventing creditors' enforcement actions.

The rights of creditors benefiting from a security governed by the Luxembourg law dated August 5 2005 on financial collaterals are not affected by a bankruptcy or reorganisation proceedings and therefore remain enforceable.

2.3 Can a creditor or a class of creditors be crammed-down?

Luxembourg law does not allow for creditors or classes of creditors in a bankruptcy to be crammed-down on an involuntary basis. Ranks of claims are established by law and cannot be changed by a court or bankruptcy receiver's decision.

In reorganisation proceedings, once the legal majorities (50% or 75%) of voting creditors are reached and the court has approved the reorganisation plan is enforceable against all the creditors, including dissenting creditors and those who abstained from voting.

If the value of an asset subject to a preferred right (security *in rem*) is lower than the debtor's liability, that value will be paid by preference to the preferred creditor, while the remaining portion of its claim will rank equally with other unsecured creditors.

2.4 Is there a process or practice for facilitating the sale of a distressed debtor's assets or business?

In a bankruptcy, the sale of an asset is under the control of the bankruptcy receiver and requires the court's approval and the court appointed judge's report on the sale. In practice, the bankruptcy receiver will file a demand in the court, providing evidence of the debtor's ownership of the asset and, if already available, the pre-agreed terms and conditions of the sale.

Luxembourg law does not provide for any specific accelerated or pre-packed form of sale nor for any other proceeding.

2.5 What are the duties of directors of a company in financial difficulty?

As a general principle, directors must always act prudently and diligently.

When a company faces financial difficulties, prudent and diligent directors would normally take advice from financiers or lawyers, avoid incurring additional liabilities, or seek arrangements with creditors to delay payments, restructure the indebtedness, or enter into a standstill agreement.

Sporadic provisions of the law of August 10 1915 on commercial companies (the company law) or the Commercial Code

require directors to take certain actions in certain circumstances.

In public companies, directors are required to convene a shareholders' meeting to resolve on the dissolution of the company when they have ascertained a loss of more than a half of the company's share capital.

A company having ceased to pay its debts as they fall due must file for bankruptcy within one month. This filing requirement lies ultimately with the directors.

In a bankruptcy, directors can be held personally liable when their actions or inaction lead to the bankruptcy or seriously increase the liabilities of a distressed company.

During a bankruptcy or reorganisation proceedings, directors have the obligation to cooperate with the bankruptcy receiver and the court.

2.6 How can any of a debtor's transactions be challenged on insolvency?

Transactions can only be clawed back or challenged in a bankruptcy. A clawback is initiated by the receiver and debated in court. Only specific transactions can be challenged.

Transactions entered into during the hardening period (*période suspecte*) – fixed up to six months before the bankruptcy judgement – and up to 10 days before this period may be declared invalid if they constitute the preferential satisfaction of one creditor over another.

The court can cancel the following transactions: disposal of assets without consideration of material adequacy; payments made for debts not yet due; payments of due debts by means other than cash or bills of exchange; granting of any security for a debt contracted before the hardening period.

Any payment for accrued debt or any transactions against money made after a company has ceased its payments and before the bankruptcy judgment may be cancelled by the court if the beneficiary of the payment or the contracting party was aware of the debtor's cessation of payments.

Mortgages granted during the hardening period (or 10 days before) may be cancelled if their registration has not been performed within 15 days of the conclusion of the mortgage agreement.

Payments made in fraud of creditors' rights are void irrespective of the day they were made.

2.7 What priority claims are there and is protection available for post-petition credit?

The following claims have statutory priority rights for reimbursement over the insolvency mass (*masse des créanciers*): judicial expenses (including bankruptcy receiver's fees); funeral expenses; fees and expenses for last illness; and, public treasury claims and salary debts.

The Luxembourg Civil Code lists the claims benefiting from a general preferred right on a debtor's movable or immovable assets. These preferred rights supersede any security *in rem* granted to a creditor.

Securities granted to creditors over financial instruments or receivables under the Financial Collateral Law remain enforceable despite the opening of a bankruptcy or reorganisation proceedings.

There is no legal protection available for creditors lending money to a bankrupt company.

2.8 Are there any sectors or industries with their own or modified insolvency and restructuring regimes?

Credit institutions and investment firms benefit from different reorganisation/insolvency regimes.

The European Directive of May 15 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms was implemented in Luxembourg by a law dated December 18 2015. The reorganisation procedures for these institutions are as follows:

- The resolution procedure aims to restructure credit institutions encountering serious financial difficulties to allow the continuity of their core activities and avoid any systemic impact, through: (i) a disposal of part or all of their business; (ii) the creation of a bridge bank where all good assets and essential functions are transferred while the bad assets and non-core functions remain with the bad bank for future liquidation; (iii) a segregation of assets, or; (iv) bail-in.
- The suspension of payments may be opened at the request of the *Commission de Surveillance du Secteur Financier* (*CSSF*) or the credit institution where: (i) it is unable to raise credit or faces temporary liquidity difficulties (whether or not it has ceased its payments); (ii) its ability to meet its commitments is entirely compromised; or, (iii) its authorisation has been withdrawn and the decision has not yet become definitive. The petition for suspension of payment triggers the automatic stay of enforcement actions. The credit institution will be able to operate under the control of court-appointed administrators.
- The institution can be subject to a judicial liquidation if the suspension of payment fails, if it can no longer meet its commitment or if its authorisation has been definitively withdrawn. In such instances, a liquidator will be appointed by the court to liquidate the assets of the entity and repay the creditors. Procedural rules are similar to rules applying to bankruptcy proceedings.

SECTION 3: Cross-border cases

3.1 Can restructuring or insolvency proceedings be opened in respect of a foreign debtor?

The competence of Luxembourg courts to allow reorganisation proceedings or open a bankruptcy is limited to debtors located within Luxembourg's territory.

However, Luxembourg courts would be entitled to exercise jurisdiction over a foreign debtor in the event: (i) urgent and protective measures were required to be taken; (ii) of absence of other competent jurisdiction or; (iii) as secondary proceedings under the Insolvency Regulation.

3.2 What recognition and assistance can be given to foreign insolvency or restructuring proceedings?

Luxembourg courts tend to be cooperative and generally recognise foreign insolvency proceedings in accordance with rules applying to recognition of foreign judgments.

Within the EU, any insolvency proceedings (listed under the Insolvency Regulation) opened in a member state will be recognised in Luxembourg, provided relevant provisions on centre of main interest criteria (Comi) have been observed.

SECTION 4: Other material considerations

4.1 What other major stakeholders (eg governmental or regulatory institutions) could have a material impact on the outcome of the reorganisation?

All stakeholders, irrespective of their rank or quality, have substantial power in reorganisation proceedings to the extent the viability of these processes depends on their consent.

As a bankruptcy is mainly led by the court and the receiver, stakeholders have little say in this procedure.

Reorganisation procedures affecting credit institutions and investment firms are subject to the supervision of the CSSF or the resolution committee.

SECTION 5: Outlook 2018

5.1 What are your predictions for the next 12 months in the corporate reorganisation and insolvency space and how do you expect legal practice to respond?

New legislation on business preservation and the modernisation of bankruptcy law (in the form of draft Bill number 6539 of February 1 2013) should be adopted (the Insolvency Reform). The insolvency reform contemplates implementing new reorganisation tools, such as moratorium, allowing the debtor to reach an out-of-court restructuring; a reorganisation by collective agreement; or, a judicial reorganisation by transfer of business under judicial control.

The insolvency reform will replace all prevailing reorganisation procedures in force (that is, controlled management, reprieve from payment or composition with creditors).

At European level, an EU Council Regulation on insolvency proceedings was recast into regulation number 2015/848 (the Insolvency Regulation) and entered into force on June 26 2017. Measures have been taken to improve efficiency in the resolution of cross-border insolvencies, through several means, for example: the extension of Insolvency Regulation to include pre-insolvency and hybrid proceedings; clauses avoiding forum shopping, and; specific regulation for the coordination of insolvency of groups of companies.