The new mechanics of restructuring in Luxembourg

Thibault Jauffret writes on the major reform of the insolvency framework in Luxembourg, implementing the Directive on Preventive Restructuring and Insolvency

THIBAULT JAUFFRET
Associate, LexField part of Mourant, Luxembourg

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With the Law of 7 August 2023 on business preservation and modernisation of bankruptcy law, entering into force on 1 November 2023, Luxembourg has undertaken a major reform of its restructuring and insolvency framework.

The main objective of the reform is to enable Luxembourg debtors experiencing financial difficulties to restructure their assets and liabilities efficiently and to avoid liquidations of viable businesses.

To that end, two new restructuring tools are made available, consensual reorganisation (*réorganisation amiable*) and judicial reorganisation (*réorganisation judiciaire*), the latest transposing the framework of the Directive on Preventive Restructuring and Insolvency into domestic law. These tools will replace existing restructuring proceedings, controlled management (*gestion contrôlée*) and composition with creditors (*concordat préventif de faillite*), that are rarely used in practice.

Consensual reorganisation (réorganisation amiable)

Consensual reorganisation is a flexible out-of-court negotiation framework, which is not public and not subject to any specific conditions, for the adoption of a reorganisation agreement between a debtor and all or part of its creditors, which may be confirmed by a court upon the debtor's request.

Consensual basis. There are no restrictions regarding the restructuring measures a debtor can propose to its creditors, but the reorganisation agreement is deemed a contract, requiring all affected creditors to consent to it. However, by contrast with a pure contractual framework, creditors are incentivised to consent to the reorganisation agreement. Upon confirmation of the plan by the court:

- the reorganisation agreement and any related agreements are excluded from the scope of avoidance actions in case of subsequent proceedings; and
- consenting creditors will be protected against any liability claims initiated by the debtor, other creditors or third parties in connection with the reorganisation agreement.

Assistance of a conciliator. A debtor may request the Minister of the Economy to provide the assistance of a conciliator, chosen from a list of experts, to help the debtor in negotiating and preparing either (i) a reorganisation agreement or (ii) a reorganisation plan and/or a transfer of all or part of its assets or business to be approved in the context of a judicial reorganisation.

Judicial reorganisation (réorganisation judiciaire)

Judicial reorganisation is a public and court-monitored restructuring proceeding opened at the request of the debtor (or with its consent) where the future of its business is in peril, in the short or long term. The purpose is to adopt a reorganisation plan and/or allow the transfer by court order of all or part of the debtor's assets or business.

1. Procedural features:

No petition. As from the filing of a petition for judicial reorganisation, the debtor is no longer subject to mandatory filing for bankruptcy. No insolvency proceedings may be initiated against the debtor, even where it meets the criteria for the opening of those proceedings.

Debtor in possession. In principle, the debtor remains in control of its assets and of the day-to-day operation of its business, although it may request the assistance of an insolvency practitioner chosen from a list of experts. An insolvency practitioner may also be appointed upon the request of any interested third-party, provided the party bears the costs and fees of assistance.

Stay of individual actions. The debtor may request the court for a stay initially for up to 4 months, which may be extended to 12 months. During the stay, the payment of claims arising prior to the opening of the proceeding is prohibited, subject to certain exceptions, such as wage claims. The stay also prevents enforcement actions in general, except for so-called financial collateral arrangements governed by the Law of 5 August 2005, which remain enforceable.

Contracts. *Ipso facto* clauses and clauses aggravating the costs of contracts for the debtor are automatically deactivated during a stay. A debtor may unilaterally suspend the performance of contracts (except employment contracts) and any liability claims are included in the reorganisation plan.

2. Preparation of the plan:

Scope of the plan. Only the debtor may prepare and submit a reorganisation plan to its creditors. The debtor determines the creditors whose rights will be affected by the plan and indicates the different categories of affected claims, the class to which each affected creditor belongs and the value of their claim within a class. The plan lists the creditors whose rights will not be affected and state the reasons for doing so.

Compulsory class composition. A creditor either belongs to the class of secured creditors or to the class of unsecured ones. Secured creditors are those secured by a lien, mortgage or proprietary reserve as well as tax and social creditors, while unsecured creditors include all remaining affected creditors.

Restructuring measures. The debtor has flexibility with regard to the content of the plan. Subject to a maximum duration of 5 years, the plan may contemplate:

(i) various measures affecting claims such as abatements, deferrals, debt-equity swaps or rescheduling of payments. However, employee claims, maintenance, tort claims resulting from physical injury and criminal penalties may not be so affected;
(ii) operational reorganisation measures, such as redundancies and transfer of all or part of the debtor's business. Where such a transfer is contemplated, an insolvency practitioner shall be appointed to monitor the bidding process and prepare the transfer agreements for the court's selection and approval; and
(iii) new financing for the implementation of the plan.

3. Vote on the plan by affected creditors:

Voting method. All affected creditors are convened to vote on the plan at a physical hearing held at the court and on a date it sets. Creditors may vote in person or by proxy. Their voting right is proportionate to the claims within the class.

Requisite majority. A plan will be considered as adopted when creditors with a vote and representing more than 50% in value within each class of creditors have voted in favour.

4. Confirmation of the plan by the court:

Binding effect. Confirmation of the plan by the court follows on the hearing where the affected creditors have voted in order to bind all affected creditors, including dissenting ones.

Conditions. The court will confirm a plan, whether adopted by the creditors or not, only if the following conditions are met:

(i) the plan complies with the formalities and conditions required by law;
(ii) it gives reasonable prospects for the avoidance of the debtor's insolvency and ensures the viability of its business; and
(iii) it does not breach Luxembourg public policy rules.

Confirmation of adopted plans. Where a plan has been adopted by each class of creditors, the court will verify that the plan complies with the following conditions:

(i) principle of equality between creditors: claims of the same category shall receive the same treatment. A category may include claims of similar size or nature. Conversely, differentiated treatments may be proposed to claims of different category;
(ii) satisfaction of the best-interest-of-creditors test: no dissenting creditor shall be worse off under a reorganisation plan, than they would be in the case of bankruptcy or liquidation or in the event of the next-best-alternative scenario; and
(iii) protection of secured creditors: a dissenting secured creditor may only be subject to a stay of 24 months, which may be extended to 36 months under certain conditions. In case of a transfer of assets, creditors' rights are automatically transferred to the purchase price of such assets.

Cross-class cramdown. Where a plan has not been adopted by each class, the court may still confirm a plan, under the cross-class cramdown mechanism, if:

(i) the plan was adopted by the class of unsecured creditors;
(ii) the class of secured creditors is treated more favourably than the class of unsecured creditors (relative priority rule); and
(iii) none of the affected creditors receives more than the amount of its claims.

Second chance. Where the court refuses to confirm a plan on the basis of non-compliance with the formalities and conditions required by law or breach of Luxembourg public policy rules, it may grant the debtor one second chance to present, within a certain time, an amended plan that would comply with these requirements. ■

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