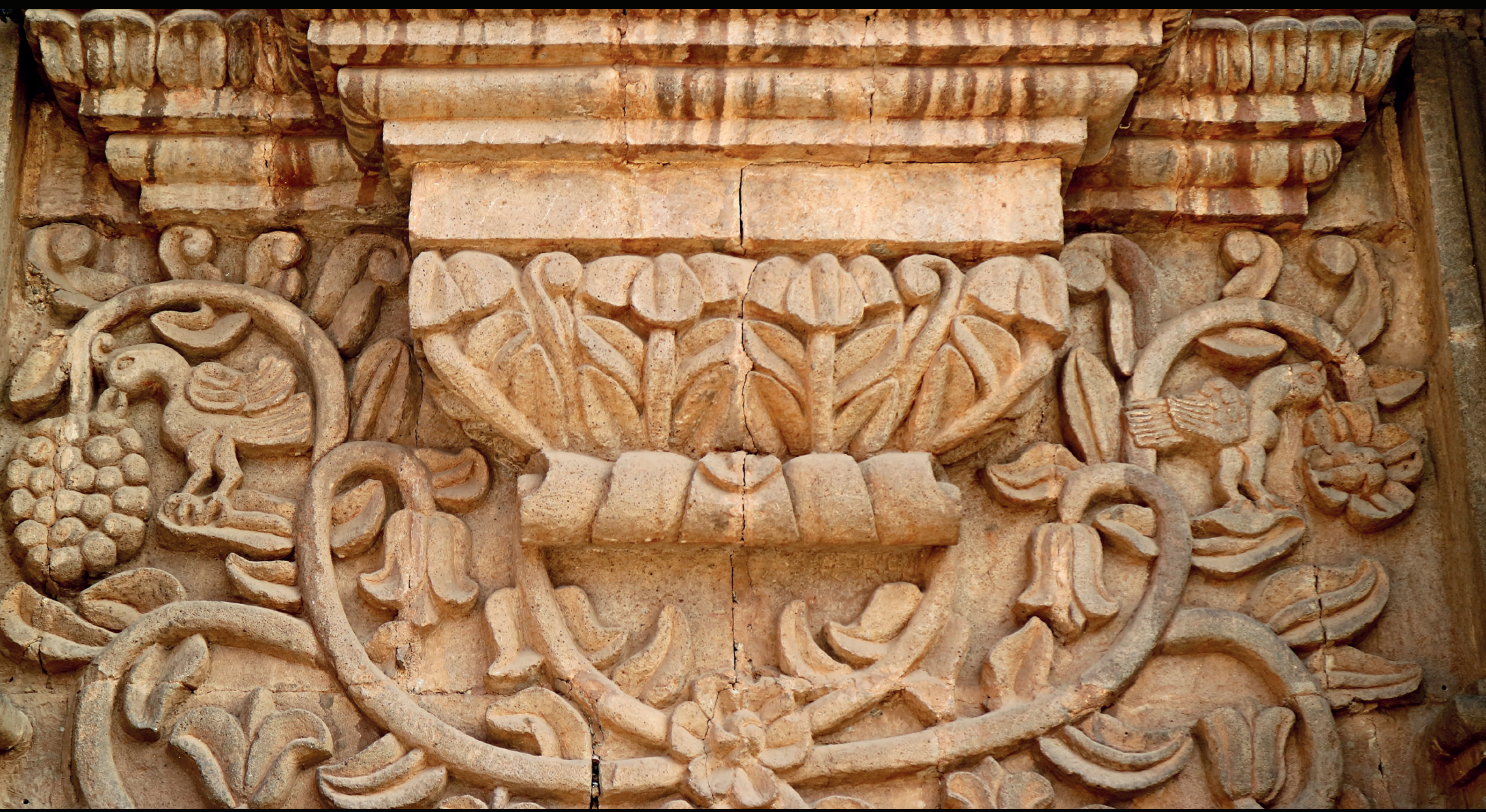
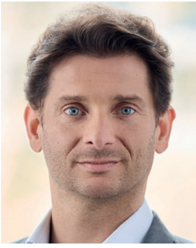
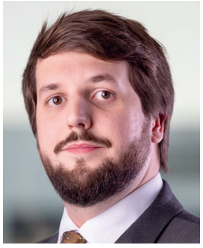
International Insolvency & Restructuring Report 2025/26



9th Edition

Common struggles faced by international creditors in Luxembourg bankruptcy proceedings





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A large number of international corporate groups conducting their activities all over the world have holding or finance companies in Luxembourg. Naturally, further to the 2007-11 global financial crisis, business law firms witnessed a surge of international debt restructuring and insolvency proceedings involving large groups of companies. By reason of the recent downturn post Covid-19 pandemic, history has repeated itself and a number of international creditors need to handle situations involving financially distressed debtors. The present note addresses selected aspects of Luxembourg bankruptcy law which international creditors may encounter – and should watch for – when seeking to have their debtors declared bankrupt in Luxembourg or, on the contrary, when trying to assess the bankruptcy risk as they negotiate a distressed investment or a debt restructuring with a group comprised of key entities located in Luxembourg.

Satisfying the "loss of creditworthiness" criteria

In such situations, an international creditor's first struggle relates to determining when the conditions of bankruptcy under Luxembourg law are met.

A commercial entity is bankrupt under the Luxembourg Commercial Code ("LCC") when (i) it has ceased its payments (*cessation des paiements*) and (ii) its credit is exhausted (*ébranlement du crédit*).[1]

Whether the first condition is met can be objectively determined as case law has ruled that the failure to pay a single undisputed, certain, liquid and due debt is sufficient for the District Court to declare a company bankrupt. A creditor may satisfy this requirement by obtaining a judgment against its debtor.[2] Seeking to have a debtor declared bankrupt is a measure of last resort and courts do not look favourably on creditors applying for bankruptcy to put pressure on debtors. Thus, when creditors obtained a judgment recognising their claim being due and payable, courts may find it relevant to assess whether the creditor has engaged sufficient efforts to have the judgment enforced before initiating bankruptcy proceedings.

The second condition is less clear-cut and more subjective, as a commercial entity is deemed to have lost its creditworthiness if its trade or business partners refuse to continue trading with it. As it concerns the debtor's internal affairs, information on other creditors' unwillingness to trade with the debtor may not easily be available. Yet, when a creditor applies to the District Court to have a debtor declared bankrupt, it must ensure that both conditions of bankruptcy are met on the day that the bankruptcy judgment is rendered.

Case law provides little guidance as to when or how the second condition is met, and courts often tie the loss of creditworthiness to the debtor's cessation of payments since one's failure to pay its debts as they become due would logically not inspire trust to equity, debt or commercial partners.[3] Loss of creditworthiness may thus be both the cause and the consequence of the cessation of payments. In theory, the existence of one single debt may lead to the loss of creditworthiness if it is sufficient to jeopardise the debtor's affairs entirely.

In order to demonstrate that the "loss of creditworthiness" criteria is met, creditors may seek to provide any evidence that the activities of the debtor are frozen by reason of other creditors' unwillingness to wait to collect what is owed to them, suppliers' refusal to deliver (unless paid in cash), financial institutions' refusal to lend funds, or that the debtor proceeds with payments to ordinary creditors to the prejudice of preferred creditors.[4] One supplier's refusal to deliver may constitute evidence of loss of creditworthiness, but on its own will generally not be sufficient as the criteria concerns the general commercial loss of one's credit in the eyes of trade partners.

How many trade partners must have lost their confidence in the debtor for the criteria to be met? As can be expected, Luxembourg case law does not provide any figures or indications, but rather takes all circumstances and evidence submitted into consideration. Doctrinal guidance provides that a commercial entity is deemed to have lost its creditworthiness when there is no longer a sufficiently broad consensus of creditors maintaining their confidence in the debtor, which results in the debtor not being able to pursue its activities.[5]

A *contrario*, the same reasoning could be used to evidence that, where the creditor group shows willingness to discuss alternatives to bankruptcy, the Luxembourg board could be comforted in not having to file for bankruptcy as creditor support would mean that said company may not have lost its creditworthiness.

In practice and in particular in a restructuring context, this is clearly the approach taken by the market and by most Luxembourg company boards, in particular in cases where a judicial restructuring is brought forward abroad (typically, via a UK Scheme or foreign equivalent or a US Chapter 11 proceeding). Creditors would often use this approach and contact the board of directors of a Luxembourg debtor company to ensure willingness to constructively discuss alternatives to bankruptcy to avoid that the board precipitates a bankruptcy filing and cuts off all changes to restructure also the wider group.

Facing oppositions after having had a debtor declared bankrupt

Even when the conditions of bankruptcy are met and a judgment declaring a commercial entity bankrupt is rendered, the bankrupt company (or other creditors) may seek to oppose it.[6]

The publication of the bankruptcy in the local Luxembourg newspapers starts an eight-day period for the bankrupt company (or a 15-day period for interested parties such as other creditors) to file an opposition, before the same court that rendered the bankruptcy judgment.[7] The objective of this opposition procedure, or third-party opposition procedure (*tierce opposition*) when initiated by an interested party, is to retract the bankruptcy judgment. Grounds upon which one may rely to submit such opposition include the following:

(i) The bankrupt company does not qualify as a merchant (*commerçant*) in accordance with the LCC. The LCC does not define the term "merchant" but rather widely defines a merchant's acts.[8] These generally include most commercial activities, banking and financial operations. Commercial companies are deemed merchants irrespective of their activity. It becomes quickly obvious whether one may rely on this ground to seek to have a judgment retracted.

(ii) The Court is not competent to declare the company bankrupt. In the vast majority of cases, the competence of the court will be difficult to dispute, but opportunities arise when a company is incorporated in two jurisdictions, where the Luxembourg company was just an empty shell or without sufficient Luxembourg substance or where its centre of main interests ("COMI") was located in another EU jurisdiction. In such a case, evidence that the COMI is not located in Luxembourg is necessary, including commercial, economic and fiscal ties with another jurisdiction. The courts of this second jurisdiction should be held competent to handle the bankruptcy rather than the Luxembourg courts. In most of these cases, choosing a jurisdiction to open bankruptcy proceedings is a strategic decision.

(iii) The bankrupt company is not in cessation of payments. With respect to the first condition of bankruptcy, the bankrupt entity may seek to establish that it is not in cessation of payments as the conditions of the debt (that it is certain, liquid and due on the day of the bankruptcy judgment) are not met. The bankrupt company may also argue that, even if a judgment recognising the creditor's claim was rendered against it, such creditor may not have taken all necessary steps to have it enforced or recognised, and thus that an application for bankruptcy against it would be premature and not an appropriate means of recovery. Opportunities to oppose on this ground also arise in the event of contingent claims such as guarantees, which may come as a surprise to international creditors. In a number of common law jurisdictions, a creditor may provide evidence of all debts and liabilities of the debtor, present, future or contingent, in order to have the debtor declared bankrupt. In Luxembourg however, one may oppose a bankruptcy judgment on the ground that debts have not yet matured and are thus not sufficiently certain if they are contingent or future. This may be the case if the debtor acts as guarantor in a contractual arrangement.[9]

(iv) The bankrupt company has not lost its creditworthiness. With respect to the second condition of bankruptcy, the bankrupt entity may seek to establish that it continues to benefit from payment deferrals or maturity extensions, that it is able to renegotiate agreements, get new funds, that its commercial affairs are not seriously disrupted, and provide evidence of the quality of its commercial organisation and reputation. When facing such oppositions, it is advisable for creditors to pay close attention to the status of the debtor's payments to social security bodies as it may have failed to pay these to artificially maintain its credit and give an appearance of creditworthiness.

Relinquishing control to the trustee

Contrary to what many foreign creditors would expect, creditors play a minor role in the Luxembourg bankruptcy process. Once appointed by the court (without consultation of any third parties, including creditors), the trustee represents the interests of both the bankrupt company and its creditors, and will not seek the creditors' approval or views when taking any decisions. Rather, the trustee acts under the supervision of the supervisory judge (*juge-commissaire*) which is appointed at the same time as the trustee in the bankruptcy judgment. There is also no credit bidding process under Luxembourg law and the trustee does not have to consider bids made by any creditors.

Creditors may reach out to the trustee to draw its attention to the bankrupt company's financial status, any suspicious prior commercial acts or possibly fraudulent transactions, which the trustee may seek to challenge to recover monies for the benefit of creditors as a whole.[10] Trustees also have the power to initiate proceedings against directors of the bankrupt company under Art. 495 LCC, Art. 495-1 LCC and Art. 441-9 of the law of 1915 on commercial companies. While the trustee is under no obligation to respond to creditors' communications, it is likely to take into consideration any objective information and facts.

However, in our experience, Luxembourg trustees are unlikely to accept creditors' requests to form a committee of creditors and convene regular meetings to consult them, get their views and answer their questions. This contrasts drastically with the approach taken by certain other jurisdictions.

This being said, we note that trustees are often willing to keep the creditors updated as to the steps taken during the bankruptcy process. In certain cases, trustees have set up websites to inform creditors of the evolution of the situation of the bankrupt company, of the assets recovered, the steps taken by the trustee (e.g. investigations, proceedings, etc.) and to communicate with the creditors generally. This may provide creditors with guidance on the next procedural steps, the conduct of the process which they may not be familiar with and an opportunity to state their position.

Assisting with securing funding to initiate proceedings on the merits

When a trustee believes that it has grounds to seek the annulment of a transaction, during the hardening period or prior to it, or recover assets from the bankrupt company's directors, it will start legal proceedings by way of a writ filed before the District Court sitting in commercial matters, and make the case for the reimbursements of the amounts.

Taking such steps may require the trustee to have funds already at its disposal within the bankrupt company's estate. In cases where little or no assets are available, the trustee may seek outside funding from third parties if it is in the best interests of the bankrupt company and of its creditors. Typically, trustees have three options:

(i) If the bankrupt company has claims against third parties, the trustee may sell these claims, likely at a discount. The bankrupt company's movable goods (such as claims) may be sold with the authorisation of the court, which, upon the supervisory judge's report, will determine the conditions of the sale.

(ii) Trustees may seek funds from creditors and may enter into funding agreements with the authorisation of the court. Typically, creditors funding litigation expect to be reimbursed first for such expenses on any recovery.

(ii) Trustees may also approach third-party funders which business model is to finance the costs of the proceedings (legal costs, expert costs, etc.) typically in exchange for a percentage of the proceeds and/or a multiple of their investment. In practice, third party litigation funders seek to recover at least 2 or 3 times the amount invested, which generally corresponds to 20 to 40% of the total amounts recovered, depending on the risks taken.[11] Third-party funding is not regulated in Luxembourg and it has become common practice for third-party funders to invest in Luxembourg litigation claims.

Luxembourg directors' duties in an insolvency context

Creditors often try to assess the Luxembourg board of director's strategy when the Luxembourg company is in financial distress and there could be a risk of their filing for bankruptcy. We also often see that, especially US creditors try to pressure boards into following their views on what to do with the companies' assets to satisfy their claims.

In this context, the fact that directors have a legal duty under Luxembourg law to file for bankruptcy within one month of the cessation of payment sometimes puts a strain on debtor-creditor discussions. This obligation is subject to criminal sanctions,[12] but may be suspended in the event that the debtor company files a request for judicial reorganisation and for the entire duration of the stay (*sursis*).[13]

Under Luxembourg law there is no concept of "fiduciary duty" as such, similar to the one under US law for instance. However, the directors of a Luxembourg company must act with loyalty, honesty and in good faith and for the Luxembourg company's corporate benefit.

When a creditor seeks to bring forward a claim against the directors of a Luxembourg company for failure to comply with their duties, the burden of proof is high as the creditor would need to prove (i) a fault/negligence (violation of the articles of association and/or the law or under the general principles of tort); (ii) a prejudice or loss that the creditor sustained as a result (which must be a personal prejudice and not simply a general one); and (iii) the causality between the fault/negligence and the loss or damage incurred. When assessing the interests of the company, directors should primarily consider the company on a standalone basis, and not the interests of the broader corporate group unless these are linked to the individual interest of the Luxembourg company itself.

Luxembourg law also sanctions situations where directors use the company for personal purposes and do not respect the principle of the company as a separate entity, its object and the functioning of its bodies. In this respect, the provisions of Art. 495 LCC allow to extend the bankruptcy of the company to the directors personally when (i) they pursued their own interests while seeming to act on behalf of the company; or (ii) they used the company's goods/assets as their own; or (iii) they abusively pursued, in their personal interests, an operating deficit which could only lead to the company's cessation of payments.[14]

Further, when it appears that the assets of the bankrupt company are not sufficient to satisfy its creditors, the trustee or the public prosecutor may petition the Court to declare that the directors shall be held liable for the debts of the company, in whole or in part, jointly and severally, if it can be demonstrated that the directors' gross misconduct led to the company's bankruptcy.[15]

This action seeks to force the directors to cover the company's liabilities and is not common in Luxembourg since it would be necessary to establish that the directors' wrongdoings (and possibly fraudulent intent) were sufficiently serious to have significantly contributed to the company's bankruptcy. The causal link between the wrongdoing and the bankruptcy is essential for this action to succeed.

No specific duties are imposed on directors if the company encounters financial difficulties, other than to closely and regularly monitor the company's financial situation and take any measures that may be deemed necessary and appropriate, to allow the company to continue its existence and avoid a value-destructive Luxembourg insolvency/liquidation process. In particular, there is no requirement or expectation under Luxembourg law that directors of a distressed or insolvent company would have to hold the assets of the company on trust for the benefit of its general body of creditors, or any particular creditor. The directors' responsibility in a financial distress scenario remains to continue to act in the best interest of the company.

A trend towards business continuity in the law of August 7, 2023

The long-awaited law of August 7, 2023 on business preservation and modernisation of bankruptcy law (the "Reorganisation law"), entered into force on November 1, 2023 and contains a broad range of new preventive reorganisation measures and proceedings. These are expected to offer a credible alternative to bankruptcy proceedings, which used to be the most common court run proceeding for distressed companies and did not allow any non-liquidation, non-value destructive alternative.

The new preventive measures under the Reorganisation law are designed to detect financial difficulties at an early stage, and introduce judicial reorganisation proceedings such as (i) the amicable agreement (*réorganisation par accord amiable*), (ii) the reorganisation plan by collective agreement (*réorganisation judiciaire par accord collectif*) or (iii) the judicial transfer to third parties of the debtor's assets or activities (*réorganisation judiciaire par transfert par décision de justice*).

Judicial reorganisation proceedings have been widely used by debtors since the law came into force and the Luxembourg courts have had numerous opportunities to provide guidance. The main effect of the judicial reorganisation, once granted by the court upon the request of the debtor, is the suspension (*sursis*) of enforcement measures and of payments for (in principle) four months with a possible extension to 12 months from the judgment granting the suspension. The duration of the suspension depends on the complexity of the case and seeks to strike a balance between the need to protect the debtor and the creditors' rights, while providing a real chance for negotiations with creditors.

A request to open judicial reorganisation proceedings may be used by debtors as a dilatory tactic as good faith is not required to file such request. The courts recently sanctioned obviously abusive behaviour and refused to grant an extension in a case where, after a total suspension period of eight months, the debtor had not provided concrete offers to its creditors with a view to reach an agreement on a reorganisation plan.

Also, whether the conditions of bankruptcy are met bears no impact on the opening or on the continuity of the reorganisation proceeding, and the courts have taken significant freedom to apply this rule, even in cases where the extent of the gap between the debtor's assets and liabilities rendered the chances of success of a collective agreement with the creditors slim.[16] In a case where the debts amounted to nearly €7m and the debtor only had €28,000 in cash, the court nonetheless granted the opening of the proceeding on the ground that the debtor's order book and orders commitments would still render it viable.[17]

A substantial number of court cases have now been filed in respect of the different proceedings available under the restructuring law and we should get more clarity on the overall framework during the year 2025 but in the meantime, there is still a certain level on uncertainty as to how the assessment of the restructuring plan is done, how much leeway the courts will take when deciding that the company should be put into bankruptcy instead or the plan breaches the equal treatment of creditors' principle etc.

For more information on the Reorganisation Law, check out our interview with the Delano paper entitled New bankruptcy law brings "rescue culture" but also "blind spots", and read our snippet series covering the practical impact of the new Luxembourg Restructuring and Insolvency toolbox.

Notes

1 Article 437 LCC.

2 A commercial entity seeking to declare voluntary bankruptcy (aveu de faillite) must submit its balance sheet with evidence of the extent of its liabilities and subsequent warranty calls from its creditors. It should however be noted that there have been certain instances where the Luxembourg court did not request a court order to evidence that the claim was indeed due.

3 The reverse is not necessarily true as a company would not be found bankrupt if it maintains strong credit with partners despite having ceased its payments.

4 Trib. Lux., 10 février 1995, n°44568 ; CA, 4 décembre 2013, n°40250 ; CA, 12 novembre 2014, Pas. Lux., 2015/5, p. 340-345.

5 See generally M. Mailliet, Manuel de droit Luxembourgeois de la faillite, Larcier 2022, page 57 et ss.

6 In practice, one does not have any opportunity to object before the bankruptcy judgment is rendered.

7 Article 473 LCC.

8 Articles 2 and 3 LCC.

9 An uncalled guarantee may therefore not be sufficient to instigate a guarantor's bankruptcy proceeding or even get an uncalled guarantee's claim recognised in a bankruptcy proceedings. Creditors should be wary as to whether it is ultimately in their best interests to pursue bankruptcy proceedings in Luxembourg, or whether they may have other means at their disposal to force the debtor into an out of court settlement.

10 A trustee may rely on several provisions of the LCC to seek to annul payments and transactions made by a bankrupt company concluded during the "hardening period" (période suspecte), usually starting six months and 10 days prior to the bankruptcy judgment, on the basis of Arts. 445 and 446 LCC. Irrespective of the hardening period, a trustee may rely on Art. 448 LCC to challenge any fraudulent payment and transactions made prior to the bankruptcy and which are damaging to the creditors as a whole, without any limitation of time.

[11] M. Mailliet, Manuel de droit Luxembourgeois de la faillite, Larcier 2022, page 270.

[12] Article 490§3 of the Luxembourg Criminal Code

[13] New Article 440 LCC.

[14] Directors may be declared personally bankrupt when one of these conditions is met, provided that the usual conditions of bankruptcy are also met (they can be considered as merchants, lost their creditworthiness and are in a situation of cessation of payments).

[15] 495-1 LCC.

[16] Thomas Mastrullo, Panorama du droit luxembourgeois de la prévention et de la restructuration après la loi du 7 août 2023 sur la préservation des entreprises, JurisNews - Procédures d'insolvabilité, 2024/1-2 - 1 June 2024.

[17] 10 January 2024, TAL-2023-10048, RJ-2023/0007.

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