Practical impact of the new Luxembourg Restructuring & Insolvency toolbox

Snippet Series

Our Luxembourg Restructuring & Insolvency team has written a series of snippets on LinkedIn covering the practical impact of the introduction of new tools for bankruptcy prevention.

All snippets can be found in this document.

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Fundamental change in the insolvency landscape

The new Luxembourg Restructuring Toolbox fundamentally alters the existing insolvency law landscape. It replaces the existing, albeit largely unused, alternatives to bankruptcy proceedings with the new judicial and extrajudicial tools.

It remains to be seen whether the new restructuring tools will be used more eagerly by the courts and practitioners who previously tended to turn to bankruptcy as a default solution. Indeed, it was considered that bankruptcy offered better guarantees to creditors than the alternative solutions of controlled management and composition with creditors.

The courts now retain the power to switch from judicial reorganisation proceedings to a bankruptcy if the debtor is manifestly unable to maintain business continuity or, as a sanction, if the debtor gives incomplete or incorrect information to the court.

The courts may also refuse to ratify a reorganisation plan, but only in limited circumstances, notably if the plan is contrary to public order or does not offer a "reasonable perspective" to avoid the insolvency of the debtor.

It remains to be seen how the courts and insolvency practitioners will react in practice to some of the fundamental changes which profoundly challenge the way Luxembourg law has looked at insolvency and restructuring for over a century.

What is the impact on the double Luxco and the Luxembourg share pledges?

Luxembourg bolsters its position for the structurings of international investments with the introduction of new tools for bankruptcy prevention. The existing and new financial collateral arrangements maintain their bankruptcy insolvency proceedings remote status, preserving the benefit and popularity of the double Luxco structure and the related enforcement of Luxembourg share security.

Luxembourg financial collateral arrangements will thus continue to provide creditors with leverage in restructuring negotiations but also offer enhanced flexibility and resilience in navigating challenging financial landscapes.

The new judicial reorganisation by collective consent: what is it?

The judicial reorganisation by collective consent (*réorganisation judiciaire par accord collectif*) is a promising and flexible new judicial reorganisation proceeding aiming at preserving the continuity of all or part of the assets or the business of a debtor under the supervision of the court.

In particular, it:

- can be proposed when the continuity of the business is threatened shortly or in the long term;
- is, in principle, a 'debtor in possession' process, subject to the designation of
  (i) an insolvency practitioner (*manditaire de justice*) to assist the debtor (at the request of the debtor or an interested third-party) or
  (ii) a provisional administrator (*administrateur provisoire*) (at the request of any interested party or public prosecutor) in case of serious faults (*fautes graves et caractérisées*);
- is subject to creditors' approval – in each class, by a majority of creditors, representing at least half of the sums owed in principal (two classes of creditors being contemplated – 'ordinary' and 'extraordinary' creditors);
- provides for a cross-class cram-down mechanism permitting such a plan to be imposed on a dissenting class of creditors;
- is subject to court oversight and sanction.

- Read The new judicial reorganisation by collective consent: key features to learn more.

Court approval of the restructuring agreement

The new Luxembourg Restructuring Toolbox permits distressed companies to have their restructuring agreements with creditors approved by the court – what for if the creditors agree?

Having the restructuring agreement approved by the court protects the actions of implementation from the clawback period of up to 6 months and 10 days. In order to qualify, the restructuring agreement needs to be concluded with all or at least two creditors with the view of reorganising all or part of the assets or activities of the debtor. It's particularly relevant when the agreement is concluded with some – but not all – creditors.

The approval by the court offers limited protection as it only covers clawback of payments, and the protection does not extend to clawback of property transfers for free or at significantly reduced values nor to granting of security interest for pre-existing debts (with the important exclusion of financial collateral). In most international transactions, the protection will likely be sufficient.

The new judicial reorganisation by collective consent: what does it entail?

What are the main effects?

- Subject to certain exceptions, no bankruptcy, judicial liquidation or enforcement measures can be declared or taken
- Suspension of the obligation to file for bankruptcy Stay on payments (for an initial maximum period of up to 4 months, with possible extensions up to a total maximum of 12 months)
- Subject to certain exceptions and to applicable contractual provisions, continuation of contracts
- Possible suspension of execution of certain agreements when reorganisation imperatively so requires

What can be agreed?

- Measures under a reorganisation plan may take many forms aiming at remedying the company's financial difficulties, notably:
- Amendments of existing financial agreements, for instance:
  - extension of payment term;
  - debt reduction in principal and/or interest;
  - differentiated settlement of certain categories of debts, in particular according to their size or nature;
  - waiver of interests or rescheduling of such interest payment; or
  - set-off of amounts realised against the principal amount of the debt as a priority;
- Debt for equity swaps

The reorganisation plan must meet the criterion of the best interests of the creditors.

Read The new judicial reorganisation by collective consent: key features to find out more!

The important distinction between 'ordinary' and 'extraordinary' creditors in a Luxembourg reorganisation plan by collective consent

The New Insolvency Law makes a distinction between 'ordinary' and 'extraordinary' creditors (*créanciers sursitaires 'ordinaires' et 'extraordinaires'*) covered by the stay, being in this context a court-ordered moratorium to carry out a judicial reorganisation by collective consent.

1. Extraordinary creditors are defined as the holders of extraordinary claims covered by the stay, . . ., claims covered by the stay secured by a special lien or a mortgage, the claims of creditor-owners as well as the outstanding claims of the tax and social security authorities.

2. Ordinary creditors are defined by default as the

holders of ordinary claims covered by the stay, . . ., claims covered by the stay other than extraordinary claims (as defined under 1 above).

The above distinction entails a different treatment in some respects and in particular different types of measures that can be imposed as part of a reorganisation plan by collective consent.

Read The important distinction between 'ordinary' and 'extraordinary' creditors in a Luxembourg reorganisation plan by collective consent to find out more.

Cross-Class Cramdown with Luxembourg Characteristics

The newly implemented cross-class cramdown in Luxembourg differs from that in the English restructuring plan in several important aspects. These differences should be carefully weighed when selecting the preferred jurisdiction for filing.

In Luxembourg, there are for now only two possible classes of creditors, and creditors are assigned to their class based on the nature of their claim and the related security Consequently, creditors holding debt with varying commercial terms might be grouped together, unlike the English system that categorizes them in as many classes as needed and based on shared interests.

In Luxembourg, approval within each class will require the consent of a majority of voting creditors based on headcount, comprising at least half of their total debt as opposed to the UK's requirement of a 75% threshold based on value.

Either class of creditors in Luxembourg has the ability to cramdown the other, with the caveat that if "extraordinary creditors" are subjected to cramdown, they must be treated more favourably than the ordinary creditors. Moreover, the proposed plan must be in the best interests of the creditors, and neither class may recover more than the combined sum of their claims and interests. Notably, there is no "not worse off" test.

Another distinctive aspect is that Luxembourg law enumerates the reasons for which the court can reject a cross-class cramdown, leaving the court with very limited discretion in decision-making.

Parallel restructuring proceedings in light of the new Luxembourg Restructuring toolbox

Toolbox offers various restructuring options for distressed Luxembourg companies, including court approval of an "*amicable*" (consensual) agreement, judicial reorganisation by collective agreement, and judicial reorganisation by transfer of all or part of the company's assets.

Many cross-border financing transactions involving Luxembourg companies include financings where the underlying debt documentation is governed by English law. This brings into consideration how to tackle such restructurings, necessitating the need to take into account the so-called "*Rule in Gibbs*" (based on the case of *Antony Gibbs & Sons v Société Industrielle et Commerciale*, according to which, the English law debt must be discharged in accordance with the governing law of the contract and, essentially, pursuant to English proceedings).

One potential solution to implement such restructurings with a multitude of underlying debt governing laws could be anticipating parallel interconnected restructuring proceedings in the UK and in Luxembourg. Some recent successful European parallel proceedings include for instance (i) the "*Vroon Case*" (WHOA combined with the UK scheme of arrangement) and (ii) Cimolai's Italian restructuring plan "*concordato preventive*" and parallel UK restructuring plan proceedings. Since there is no mandatory requirement in both (the English and Luxembourg) proceedings to submit all creditors' claims in one single proceeding, the English law-governed debts could be compromised in English proceedings while the Luxembourg (and/or other European-governed law) debts would be restructured in the course of Luxembourg restructuring proceedings.

The role of directors in the case of insolvency

The new Luxembourg Restructuring Toolbox contains significant changes for directors of Luxembourg companies which are in financial distress and introduces more automatic criminal sanctions.

Directors of Luxembourg companies are familiar with the 30 days deadline they have to file for bankruptcy once the two cumulative conditions of cessation of payments and loss of creditworthiness are met.

The criteria and deadline remain unchanged by the reform, but the judicial reorganisation will become an attractive alternative to bankruptcy and the provisions of the law offer legal certainty to directors, who will not need to worry about the deadline to make a bankruptcy filing as long as the judicial reorganisation is ongoing.

However, since the judicial reorganisation is a "debtor in possession" process, the directors will have the responsibility to direct such process, notably by establishing a restructuring plan or by conducting negotiations with creditors under the shield of a stay on all individual creditor actions. They may be assisted in such role by a judicial agent, appointed by the court or may even be replaced, in the case of grave misconduct, by a court-appointed judicial administrator.

Finally, it should be noted that the reform aims to increase punishment for the directors who fail to meet the 30 days deadline to make a bankruptcy filing by removing any discretion of the courts in finding that they are criminally liable if the deadline was missed.

New litigation option for creditors of Luxembourg debtors

The new Luxembourg Restructuring Toolbox adds a significant litigation option for creditors of Luxembourg debtors. Creditors will be able to request the appointment of a judicial agent by showing that the serious misconduct of their debtor or its corporate bodies threatens the business continuity of the debtor. The creditor must also demonstrate that the proposed mission of the judicial agent is likely to safeguard business continuity.

Until now, Luxembourg law offered limited options to creditors faced with mismanagement of their debtor. The default option of bankruptcy often meant lengthy procedures with an uncertain outcome.

The ordinary summary judge already has the power to appoint a provisional administrator but normally only does so at the request of one or more shareholders and if the corporate bodies of the relevant company are completely blocked.

The reform creates a new balance between the interests of creditors and the traditional reluctance of Luxembourg courts to intervene in the management of commercial companies, a feature which was highlighted during the parliamentary debates.

Given that the judicial reorganisation under the law is in principle a "debtor in possession" process, the appointment of a judicial agent may potentially be used to request the opening of a judicial reorganisation in a case where the debtor is unwilling to do so, as such a reorganisation is – by definition – meant to ensure business continuity. This interpretation is confirmed by the fact that the judicial agent remains in place after the opening of a judicial reorganisation.

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