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Admission of contingent claims in bankruptcy proceedings in Luxembourg

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Introduction

When adjudicating a bankruptcy, the court asks the debtor's creditors to file their claims within a certain period and indicates the hearing dates for these claims. By declaring their claims, creditors become part of the body of creditors (*masse des créanciers*). The trustee in bankruptcy (*curateur*) can decide on the status of contested claims and establish a list of claims and a distribution plan. It is, therefore, important that creditors understand the criteria their claims must meet in order to be admissible in the context of bankruptcy proceedings.

The requirements for submission of a claim in bankruptcy should not be confused with the conditions that a claim must meet in order for a creditor to be able to initiate bankruptcy proceedings against the debtor – namely, the claim must be:

- certain and unquestionable (the claim actually exists and is indisputable);
- liquid (the claim can be valued in a currency that constitutes legal tender); and
- payable.

Indeed, when a debtor is declared bankrupt, a contingent claim that is certain but not yet liquid and due can be filed and accepted on a provisional basis. Creditors are responsible for determining the value of their contingent claims, and the trustee in bankruptcy must set aside a corresponding share of the proceeds to satisfy such claims. The final value of the claim will depend on fulfilment of the outstanding condition or other factors relating to whether the claim is due and liquid. For clarity, this article uses an example of a bankrupt Luxembourg company that acts as a guarantor for landlords for the payment of rent by certain affiliated tenant companies.

General obligation for creditors to file their claims

In the context of bankruptcy proceedings, creditors are generally able to file their claims against the bankrupt company. With respect to the declaration of claims, article 496 et seq of the Luxembourg Commercial Code (LCC) provide for a claim declaration and verification procedure (summarised below) with a view to ensuring the protection of creditors' rights:

- The trustee in bankruptcy verifies the claims filed with the court up to the closing date of the last review hearing (ie, the close of the claims verification procedure (*clôture du procès-verbal de vérification*). Verification is done in the presence of the bankruptcy judge and with the intervention of the bankrupt party. If certain claims are rejected or found to be improperly justified following review, the trustee in bankruptcy will notify the relevant creditors.
- The bankruptcy judge may subsequently summon those creditors whose claims are contested in order to obtain more information about their claims.
- At the last claims review hearing, any claim that has not yet been accepted or that is still contested will be subjected to cross-examination between the parties.
- Following this examination, any dispute regarding the remaining unaccepted claims will be referred by the bankruptcy judge to the competent court which shall rule on the claim's validity and admission to bankruptcy.
- If the bankrupt company emerges from bankruptcy as a going concern, all creditors of the company that did not declare their claims will in principle have their rights to request payment from the company restored and may sue the company to this effect.

As a general rule, all creditors, regardless of the nature of their claims and whether they are preferred or not, can and should file their claims. According to article 496(1) of the LCC "creditors of the bankrupt are obliged to file with the clerk of the District Court sitting in commercial matters a declaration of their claims, together with their instruments, within the time limit set in the judgment adjudicating bankruptcy" (emphasis added).

More generally, articles 496 to 507 of the LCC deal with the filing and admission of claims. These provisions do not state that only creditors with effective claims (as opposed to contingent creditors) can file them, and there is nothing in the LCC limiting the ability of contingent creditors to do so. Likewise, according to French case law and literature,[(1)] the obligation to file claims extends to contingent claims.

Nature of claims admissible in bankruptcy

To the extent that claims are certain, liquid and due (*certaines, liquides et exigibles*), little to no discussion will arise with regard to their admission to bankruptcy. However, all three criteria need not necessarily be met for the valid filing and potential admission of a claim. A

claim whose existence was certain prior to bankruptcy, but that, pending the fulfilment of a particular condition, is not yet due and whose amount may not yet be determined at the time of bankruptcy, may be validly filed and possibly accepted.

Under Luxembourg law, claims for contingent or illiquid amounts can be accepted provided they are certain.[(2)] A claim is certain when its basis cannot be contested. In the case of a contingent contractual claim, such as those of creditors under guarantee agreements entered into by the bankrupt company in the present example, the claim is certain due to the existence of the agreement.

The only question that remains is the liquidity of the claim (ie, the level up to which the claim may be accepted). The operative event underlying the claim will determine if it should be admitted as a liability of the bankrupt estate (ie, if the claim pre-dates the adjudication of bankruptcy). In the case of a contingent claim relating to a guarantee granted by the bankrupt company, the claim pre-dates the adjudication of bankruptcy as the operative event (*fait générateur*) on which it is based (ie, the entry into of the guarantee agreement) occurred prior to the adjudication of bankruptcy, meaning the claim is pre-existing and certain. As such, all beneficiaries of guarantees, in the present example, should be able to file their claims.

Similarly, a contingent claim for damages for breach of contract or liability in tort can be validly filed and admitted, even if the liability of the bankrupt company was only recognised by a judgment after the adjudication of bankruptcy (and submission of the contingent claim), as the right to compensation exists as from occurrence of the act that caused the damage.[(3)]

Belgian and French case law and legal literature (to which a court of competent jurisdiction in Luxembourg would most likely refer in this context, in the absence of Luxembourg precedent) commonly find that contingent claims can be admitted as liabilities of the bankrupt estate.[(4)]

In support of this conclusion, the Luxembourg courts, referring again to Belgian and French case law, usually consider that, in the liquidation context (and mutatis mutandis in the context of bankruptcy), claims do not need to be due at the close of liquidation in order to be admissible and may thus be contingent (eg, they do not need to be established by a judgment or form the object of a legal action).[(5)] In this regard and in the present example, the fact that a tenant has not defaulted before the opening of bankruptcy proceedings (meaning the guarantee is not yet due or of a fixed amount) does not prevent the landlord from declaring and filing a contingent claim under the pre-existing guarantee agreement.

Valuation of declared contingent claims

When filing and declaring a contingent claim, the main issue faced by creditors is that the claim may not be liquid and, therefore, its value may not be known. In practice, creditors are responsible for assessing the value of their contingent claims and generally declare an amount corresponding to the maximum amount provided under the underlying agreement (in the example at hand, the total guaranteed amount).

This approach has been validated by French case law,[(6)] and Belgian literature acknowledges that such a declaration is admissible even if the value of the contingent claim is only provisional; the expression of reservations as to the value of a contingent claim does not render the declaration inadmissible.[(7)]

The highest court in Luxembourg has held that, in the context of liquidation, the liquidator has an obligation to anticipate an amount sufficient to repair the damage resulting from defects arising after the close of liquidation.[(8)] By analogy and in the case at hand, the trustee in bankruptcy cannot refuse to consider contingent claims submitted by the bankrupt company's creditors that relate to pre-existing guarantee arrangements and is in fact obliged to take such claims into account when drawing up the distribution plan and set aside the amounts necessary to satisfy them[(9)] according to article 562 of the LCC, should they become due during the course of the bankruptcy proceedings.[(10)]

The amount set aside by the trustee in bankruptcy shall consist of either:

- the maximum value of the contingent claim (as declared by the creditor), if the contingent claim is secured (either by law or contractually, eg, the creditor benefits from a security interest in certain assets of the bankrupt company); or
- the amount to be distributed to other unsecured creditors, if the contingent claim is unsecured.

With respect to claims not yet admitted to bankruptcy, the trustee shall "set aside a corresponding share" of the proceeds.[(11)]

Time of admission of contingent claims

With respect to the admission of contingent claims in bankruptcy, if the applicable conditions have not been fulfilled by a date set by the court (and in any case no later than the date of the final hearing on all claims (ie, the closing date of the claims verification procedure) and the claim has not crystallised by that date, the amounts initially set aside by the trustee to satisfy contingent claims will be distributed to other shareholders.[(12)] Therefore, in the present example, the trustee will consider the claim certain but not liquid and due until a tenant defaults on the payment of rent. The claim will only become liquid and due if default occurs between the date of the adjudication of bankruptcy and the deadline for submission of claims or possibly the date of the final hearing on all claims (ie, the closing date of the claims verification procedure). If on this date the amount of the claim cannot be determined (and hence the claim remains illiquid), the court will simply reject it. If the amount can be determined (ie, an event of default has occurred), the claim should be accepted.

With respect to the value of a contingent claim admitted to bankruptcy, it should be noted that this amount can never be higher than that initially declared by the creditor and cannot be increased. It is, therefore, the creditor's responsibility to assess this amount when declaring a contingent claim (eg, the entire amount covered by the relevant guarantee arrangement). In practice, it is possible that the admitted amount may represent only a portion of the declared amount if, for example, the defaulting tenant (or a third party) was able to pay a portion or all of the rent.

Comment

From a strategic perspective, the shareholders of a bankrupt Luxembourg company whose liabilities include a high number of contingent claims should reach out to the company's creditors with the support of the trustee in bankruptcy in order to try to negotiate the settlement of these contingent claims with a view to the potential financial rescue of the company.

Both shareholders and creditors have an incentive to enter into negotiations, which offer shareholders the possibility to settle the bankrupt's liabilities at a discount (ie, contingent claims that are expected to crystallise in the course of the bankruptcy proceedings) and

creditors the opportunity to receive an agreed lump sum for their contingent claims.

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Endnotes

(1) Mathias Houssin, "Le droit français est-il creditor friendly, International Journal of Insolvency Law", vol 1 (2017). French Court of Cassation, Civil Chamber 1, 29 September 2004, 02-16.754.

(2) Getting the Deal Through, Restructuring & Insolvency 2017, Dentons, Law Business Research 2016, item 31, 301.

(3) Van Ryn & Heenen, Commercial Law IV, Liabilities of the Estate, 297.

(4) French Court of Cassation, Commercial Chamber, 9 October 2019, 18-18.818.

(5) Opinion of Advocate General John Petry in *Emering-Behm v Schackmann*, Luxembourg District Court, 15.

(6) French Court of Cassation, Commercial Chamber, 2 November 1993, No. 91-13767.

(7) Les Novelles, op cit, No. 2341.

(8) Luxembourg Court of Cassation, 7 February 2013, 12 No. 10/13.

(9) Ghent Commercial Court,12 October 1889, Jur des Fl, 1890, No. 577.

(10) Les Novelles, op cit, No. 2699.

(11) Les Novelles, op cit, No. 2699.

(12) Court of Cassation, 13 June 1889, I, 246: Liège Court of Appeal, 11 February 1914 and opinion of MP, BJ 280.