INSOLVENCY & RESTRUCTURING - LUXEMBOURG

Recent measures to facilitate restructuring and prevent insolvency

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Introduction

Luxembourg recently adopted a number of legislative reforms aimed at modernising the rules applicable to commercial companies. In relation to the restructuring and insolvency of Luxembourg-based entities, Parliament is discussing the long-awaited Bill 6539 (the so-called 'Insolvency Bill').

In the meantime, a number of reforms which could affect the restructuring and insolvency of commercial companies have been adopted, including:

- substantial amendments to the Companies Act 1915 which were introduced in 2016; and
- amendments to the Act on the Luxembourg Trade and Companies Register 2002, including with regard to annual accounts and publication formalities.

Although the main purpose of these changes is to modernise the rules applicable to commercial companies and the relevant publication formalities, they may also prove useful in the framework of corporate restructuring and the prevention of insolvency.

This update focuses on certain provisions applicable mainly to *societes anonymes* (ie, public limited liability companies) and *societes a responsabilite limitee* (ie, private limited liability companies) – the two most commonly used corporate forms in Luxembourg.

Measures to prevent insolvency – warning signs

Amended capital impairment rules – Article 100 of Companies Act

The board of directors of a public limited liability company must call a general meeting of shareholders if, pursuant to losses incurred, the value of the company's net assets falls below half or one-quarter of its share capital, without prejudice to stricter provisions in the articles of association.

The board of directors must prepare a special report explaining the reasons for the company's financial difficulties and justifying its proposals. If the directors propose to continue the company's activity, they must inform shareholders of the measures which they intend to adopt in order to remedy the company's financial situation. This report must be specifically mentioned in the notice calling the general meeting and a copy of the report must be sent along with the notice. Failure to provide this report will render any resolutions passed at the general meeting invalid, unless all shareholders waive this requirement.

The general meeting will then deliberate on whether to wind up the company and other measures proposed on the agenda. The meeting must be held within two months from the date on which the losses were or should have been discovered.

As of 2016, a board of directors is subject to additional rules in the event of capital impairment. It must now report on the actions that it intends to adopt in order to remedy the company's financial situation, thus introducing an additional tool to prevent insolvency.

Fines for late filing of annual accounts

In an effort to encourage companies to file their financial statements on time (ie, within seven months from the end of the financial year), as of January 1 2017 the Luxembourg Trade and Companies Register charges an additional fee for the late filing of financial statements. The longer the delay, the higher the fee – although in all cases it is capped at €500 per late filing.

This new measure encourages companies to keep their financial statements up to date and allows creditors to monitor more closely and regularly their debtors' financial situation.

Suspended payment of redemption price

The amended Companies Act clarifies the rules applicable to share redemptions by a private limited liability company.

The Companies Act now:

- requires the managers of a private limited liability company to assess the consequences of redemption; and
- allows them to decide to withhold payment of all or a portion of the redemption price if paying the full price would likely cause it to be unable to pay its debts as they fall due.

Such a decision by management suspends, until further notice, the company's payment obligation to its relevant shareholders.

These new rules protect third parties against unsound distributions by the company and reduce the risk of a suspension of payments.

Simplified winding up

A company with only one shareholder may be wound up without liquidation pursuant to a resolution adopted by its sole shareholder, in which case all of the company's assets and liabilities will be transferred by operation of law to the shareholder.

For a 30-day period starting on the publication date of the decision to wind up, creditors may petition the president of the district court for additional security.

The new procedure is subject to the prior issuance of certificates by various administrative bodies confirming that the company is in compliance with its obligations regarding the payment of taxes and social security contributions.

The amended rules aim to prevent insolvency by ensuring that winding up cannot take place before certain creditors are satisfied.

Existing restructuring options

Debt restructuring and debt-to-equity swap

The Companies Act now clarifies that the rules on the issuance of bonds, bondholders' meetings and representatives (which already existed in the Companies Act) apply to all bond issues. The following major changes were introduced in 2016:

- the issue document can derogate from these provisions; and
- these provisions may apply to all or part of an issue of securities, other than shares, by a Luxembourg-based or foreign-based company.

As a result, it is now possible to allow the general meeting of bondholders or security holders, as the case may be, to:

- modify or cancel particular securities attributed to them;
- postpone one or more interest maturity dates;
- agree to a reduction in the interest rate or amend the interest payment conditions;
- extend or suspend the amortisation period and agree to changes to the amortisation conditions;
- agree to shares in the company being substituted for bonds or other securities, as applicable; and
- agree to shares or bonds of other companies being substituted for bonds or other securities, as applicable.

However, such decisions are valid only if a statement of the company's assets and liabilities prepared by a statutory auditor and dated within two months of the decision is made available to the meeting of bondholders or security holders, as the case may be. This statement must be accompanied by a report of the board of directors justifying the proposed measures. In addition, the share capital must be paid in full before taking any of the abovementioned decisions, with the exception of the first one.

The meeting can validly deliberate only if at least half of the outstanding bonds or securities are present or represented. If this condition is not met, a new meeting must be called which can validly deliberate regardless of the percentage of bonds or securities present or represented. Decisions must be approved by two-thirds of the votes cast, excluding abstentions and blank or otherwise void ballots.

Further, where the substitution of shares for bonds results in an increase in the company's issued share capital, the share capital increase must be approved by the general meeting of shareholders within three months from the date of the bondholders' decision.

Extracts from such decisions are published in accordance with Article 11*bis* of the Companies Act.

The possibility to apply these rules to all securities issues facilitates debt-to-equity swaps in the framework of restructuring and contractual arrangements with creditors.

Capital restructuring

Since 2016, the Companies Act has contained a range of rules that allow the flexible restructuring of capital and facilitate equity financing. For example, both public and private limited liability companies can now issue shares with different par values. In addition, public limited liability companies can issue shares below par value, within the framework of their authorised capital. Further, private limited liability companies can now have authorised capital, enabling this corporate form to increase its share capital quickly and easily, which may prove useful when urgent financing is needed.

Bankruptcy reform: what to expect

Under Luxembourg law, a company must declare bankruptcy within 30 days from when it ceases to pay its debts as they fall due. The company will be declared bankrupt by the court if, in addition to a cessation of payments, it loses its creditworthiness, meaning that it can no longer attract financing. Thus, the inability to pay even a single debt could result in bankruptcy.

The main purpose of the Insolvency Bill is to allow the detection of financial difficulties at an earlier stage and thereby facilitate financial rescue and recovery.

The Insolvency Bill is intended to provide new customised tools to help distressed companies to continue their activities and protect stakeholders, notably by favouring restructuring over liquidation.

The Insolvency Bill is based on four guiding principles – prevention, reorganisation, remediation and dissuasion. It also proposes the introduction of administrative winding up without liquidation in order to lower the costs for businesses without employees.

Prevention

The objective is to avoid recourse to bankruptcy each time a company experiences financial difficulties. The Insolvency Bill identifies a number of warning signs to allow struggling companies to be identified earlier.

Once identified, such companies can request and take preventive measures without having to lodge formal bankruptcy proceedings. Such measures may include the voluntary preservation and reorganisation of business activities while taking creditors' rights into account.

Reorganisation
A new set of reorganisation possibilities will be made available to distressed companies, including extrajudicial and judicial proceedings, which can be adapted depending on the size of the company and are largely voluntary (ie, applicable at the struggling company's request).

The extrajudicial possibilities are:

- conciliation (a struggling business can request the appointment of a conciliator or business arbitrator); and
- the conclusion of an agreement with certain creditors.

Judicial proceedings mainly include:

- the conclusion of a collective agreement enforceable against all creditors for the purpose of reducing debt or deferring settlement;
- reorganisation under court supervision in order to ensure business continuity; and
- a court-ordered extension of the payment deadline in order to reach an agreement with one or more creditors.

These measures are intended to replace the existing array of proceedings which are rarely used in practice, such as:

- an arrangement with creditors;
- supervised management; and
- a stay of payments.

Remediation
These measures supplement the existing legislation, which aims to:

- give natural persons who perform activities in good faith a second chance; and
- contribute to the creation of an environment that is conducive to a fresh start.

Dissuasion
These measures are designed to dissuade bad-faith entrepreneurs from abandoning their business and starting another one. The Insolvency Bill notably provides for specific administrative winding up without liquidation aimed at eliminating 'empty shells' in a timely and efficient manner by avoiding formal bankruptcy proceedings.

Comment

The Luxembourg legislature is aware of the increasing importance of having appropriate measures to encourage restructuring and address insolvency. In addition to the extensive range of restructuring possibilities already offered under Luxembourg law and the bankruptcy remoteness of financial collateral that has existed for more than a decade, the legislature intends to modernise the restructuring and insolvency framework by means of the Insolvency Bill which, once adopted, will offer solutions better suited to meet the needs of a global economy.

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