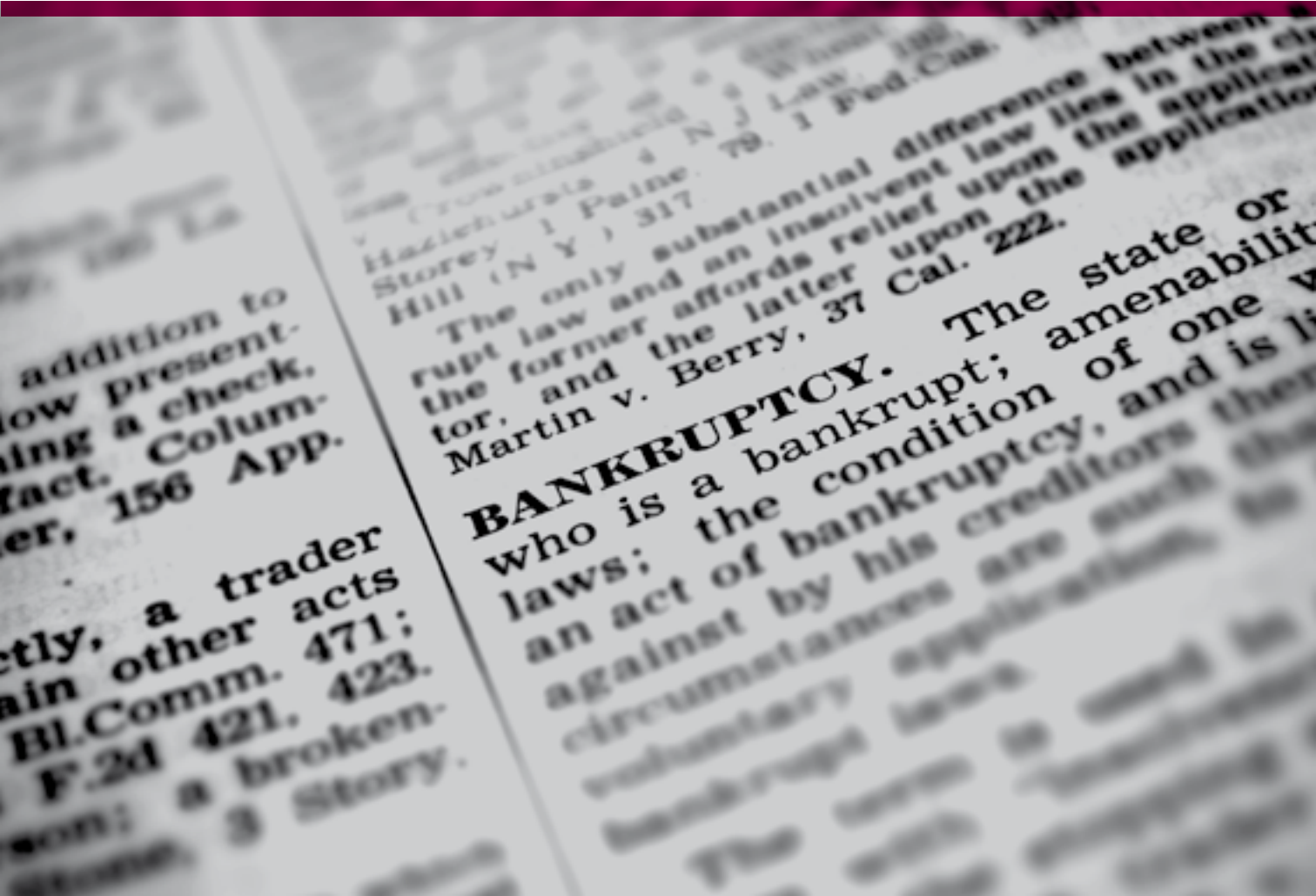


# Restructuring & Insolvency in Luxembourg

JULY 2010





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RESTRUCTURING & INSOLVENCY IN LUXEMBOURG  
OOSTVOGELS PFISTER FEYTEN  
JULY 2010

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LUXEMBOURG – LONDON

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## 01 Overview

**It goes without saying that the past few years have been quite unique. Over this period, we have seen the fall of many prominent banking institutions and have experienced some quite special situations. The repercussions of these events have greatly impacted global economies and in many jurisdictions, they have led to a spectacular level of bankruptcy, insolvency and restructuring cases.**

In Luxembourg, the economic downturn can still be felt, although to a lesser extent than most other jurisdictions. Situations such as the fall of the Icelandic banks and insolvent funds linked to the Bernard Madoff's Ponzi scheme, have, however, triggered some very busy and quite complex cases for the financial and legal communities. They have also raised a range of issues such as the role and onus of liability of financial institutions including custodian banks and necessitated the need for more open dialogue towards harmonised and stricter regulations amongst EU states and beyond.

One thing is clear from all these events: bankruptcy and insolvency of a business is more often than not, linked not just to one jurisdiction. In today's global environment, the impact can be felt on all sides of the globe and today require more in-depth knowledge and a strong international awareness to achieve a suitable outcome.

During the course of 2009, Oostvogels Pfister Feyten has once again been advising on a number of domestic and international matters including some high profile legal restructuring cases. Our focus for 2010 and beyond is to embrace the new financial era that is upon us and continue developing and enhancing each of our practices to ensure our clients have access to the skills and expertise required for this quite complex environment.

We have put together this booklet dedicated to restructuring and insolvency to provide an overview of what Luxembourg entails in this respect. We hope it will serve as a useful working tool for those of you involved with such matters and will present an understanding of Luxembourg's approach in these very sensitive situations.

## 02 Luxembourg procedures for commercial companies

**In Luxembourg, restructuring and insolvency matters are governed by the provisions of the Commercial Code, by the law of 10 August 1915 as amended (the 'Company Act') and by other specific laws.**

With regards to financial sectors and fund vehicles, they are subject to special insolvency proceedings. The main rules applicable to these companies are highlighted in Section 4 and 5 and are influenced by EU directives.

This booklet provides an overview of the main Luxembourg procedures when bringing a company's existence to an end. It refers only to companies which (i) are incorporated in Luxembourg and/or (ii) have their Centre Of Main Interest ('COMI') in Luxembourg.

According to Art 3(1) of 1346/2000 EU Regulation, for a company, the COMI is presumed to be at the place of its registered office.

However, both case law and recital 13 of the 1346/2000 EU Regulation include elements which provide the opportunity to rebut this presumption. The COMI should in fact correspond to the place where the debtor conducts the administration of his/her interests on a regular basis and is ascertainable by third parties.

During the course of 2008, bankruptcy was the most common insolvency procedure under Luxembourg law with 698 cases reported. This represented an increase compared to 2009 figures but remained below those of 2001. The next section will, therefore, focus with respect to insolvency procedures, on bankruptcy and provides an outline of the main steps and characteristics of this proceeding.

The table on the next page provides an outline of the main solvent and insolvent situations in Luxembourg.



## 02 Luxembourg procedures for commercial companies

PROCEDURE	PURPOSE	CONDITIONS	REMARKS
COMPOSITION IN ORDER TO AVOID BANKRUPTCY (CONCORDAT PRÉVENTIF DE LA FAILLITE)	This procedure permits business entities experiencing financial difficulties to avoid bankruptcy. An agreement is concluded between the business entity and its creditors under the control and subject to the approval of the Court ( <i>tribunal d'arrondissement</i> ) dealing with commercial matters ('Court').	<ul style="list-style-type: none"> <li>The business is facing financial difficulties that cannot be overcome,</li> <li>AND</li> <li>The company has obtained the agreement of the majority of the creditors representing at least three quarters of the business entity's debt.</li> </ul>	This requires the intervention of many different players which can make it arduous and time-consuming. In practice, it is not often granted by the Court.
REPRIEVE FROM PAYMENT (SURSIS DE PAIEMENT)	To allow a business experiencing temporary financial difficulties to suspend its payments for a limited period of time.	Temporary inability to pay creditors but audited balance sheet shows that assets largely exceed debts.	This proceeding is excluded after bankruptcy proceedings have been opened against the applicant. In practice, it has not been used for several years.
CONTROLLED MANAGEMENT (GESTION CONTRÔLÉE)	This allows a business entity to reorganise its business or to realise its assets under the supervision of the Court and of commissioners appointed by the Court. The commissioner draws up a reorganisation plan, which is subject to approval by a majority of creditors and ratification by the Court before becoming compulsory.	<ul style="list-style-type: none"> <li>Inability of the debtor to raise credit;</li> <li>OR</li> <li>Execution by the business entity of its entire duties being compromised.</li> </ul>	<p>According to statistics, controlled management proceedings are rarely successful and often end in bankruptcy. The procedure is very complex and entails a large number of procedural actions. However, these procedures can keep the company from going bankrupt.</p> <p>In practice, it is rarely applied (2 procedures opened in 2009).</p>
BANKRUPTCY (FAILLITE)	A formal procedure applicable to insolvent business entities in order for a bankruptcy trustee appointed by the Court to realise the assets and to repay <i>if possible</i> , on a prorata basis of the profit realised, the creditors of the company.	<ul style="list-style-type: none"> <li>Inability to pay one's creditors,</li> <li>AND</li> <li>Inability to raise credit.</li> </ul>	The bankruptcy may lead to a composition after bankruptcy but in most cases, it ends with the closure of the bankruptcy, i.e. liquidation of the company.
COMPULSORY LIQUIDATION (LIQUIDATION JUDICIAIRE)	This procedure applies to any company that pursues criminal activities or that seriously contravenes the provisions of the commercial and criminal codes, Company Act or other laws governing commercial companies.	Breach of the provisions of the commercial and criminal codes, Company Act or other laws governing commercial companies, including trade license.	<p>The Court determines the method of liquidation. It may render applicable the rules governing the bankruptcy to the liquidation, though the company might be solvent.</p> <p>The company cannot be turned around and its liquidation is inevitable.</p>
VOLUNTARY LIQUIDATION	This procedure allows the shareholders to bring a solvent company to an end and to distribute the assets to the shareholders after having paid its debts.	To be solvent.	In the case of insufficient assets, the liquidation could be turned into a bankruptcy.

## 03 Bankruptcy proceedings for commercial companies

The rules of bankruptcy provided by articles 437 and following of the Commercial Code only apply to commercial entities (individuals or companies) performing a commercial activity on a regular professional basis.

For the time being, there are only a few provisions related to this area of law and which are scattered over Luxembourg's legislation.

On 27 March 2009, a bill referenced 6021 was submitted by the Luxembourg Parliament to provide individuals who are Luxembourg residents and who do not perform any commercial activity on a regular basis, with a complete set of rules governing civil bankruptcy. The bill applies to individuals who have undergone lasting financial difficulties which have made them unable to face their non professional debts. The bill also includes in its scope individuals who have ceased any commercial business for more than 6 months.

Two stages are provided for by the bill.

1. The debtor should first negotiate a debt settlement with its creditors (*règlement conventionnel*). If they fail to reach an agreement, the debtor or any party having interest to do so, may file a petition for judicial reorganisation before the Court (*redressement judiciaire*).

2. There is then an additional procedure before the Court, where the debtor's situation is irreparably compromised (*rétablissement personnel*).

If this procedure is opened, interests and proceedings for enforcement are suspended until the closing judgement is held. The judge may appoint a commissioner to handle the bankruptcy.

### 3.1. NATIONAL BANKRUPTCY PROCEDURE

Below are some figures provided by the Luxembourg official Gazette which highlights the number of bankruptcy cases over the period 1995-2009.

Number of bankruptcy cases in Luxembourg



## 03 Bankruptcy proceedings for commercial companies

### Who can initiate the bankruptcy procedure?

- One or more creditors (*faillite sur assignation*).
- The Court by its own motion (*faillite d'office*).
- Or, the company itself through its directors / managers (*faillite sur aveu*).

### Luxembourg Insolvency Test

Two cumulative conditions apply:

- The inability to pay one's creditors, **and**
- The inability to raise credit.

### First condition of the insolvency test: measuring the inability to pay debts

Measuring whether a company has stopped paying its debts is done through a test assessed by the Court examining the request for bankruptcy on the basis of a 'snap shot in time'.

Neither the cash flow test nor the balance sheet test (recommended by INSOL or UNCITRAL) is sufficient under Luxembourg law to ascertain whether the company should be put into bankruptcy. A possible recommendation to directors in this respect is to compare the net assets at their fair market value with the liabilities (Net Asset Value ('NAV') test). Should the result of this non official test be that the NAV at fair market value is negative, the directors will need to verify one further condition i.e. if the credit is also compromised.

However, this is a fact sensitive question which the Court will take into account on a case by case basis, especially in circumstances such as an economic downturn. In this respect, directors should always adopt a cautious approach and must work alongside auditors to analyse the financial situation of the company and to assess whether the business should continue or not.

With regards to those assets which need to be taken into account, this theoretically refers to all assets, including non-current assets such as real estate. However, in practice, the Court may be reluctant to consider secured non-current assets, especially if these assets are used for securing specific debts (mortgages and pledge).

For liabilities, the Court will only consider debt that is due and payable, liquid and certain. All other liabilities, i.e. immature liabilities or disputed debt will not be taken into account.

Furthermore, a company can be declared bankrupt upon request of a sole creditor if that company fails to pay one single payment, where this payment concerns a debt which is liquid, certain and which has fallen due.

Therefore, if a company fails to meet several creditors' payments, it would be considered as technically insolvent except where there is proof that it will find credit within a very short time period.

## In Luxembourg, banks could be considered liable if they continue to grant credit to an insolvent company and they have artificially delayed the insolvency declaration (abusive lending concept).

### Second condition of the insolvency test: inability to raise credit

The notion of compromised credit depends on whether the company can quickly find credit or not. In practice, this means that:

- (i) a bank or its own shareholders will not grant any more credit to the company, or
- (ii) that the creditors are no longer willing to grant the company any delay in paying back its debts (moratorium, standstill agreement, etc.).

The availability of a credit line could also be taken into account. However, where the credit line is conditional, the Court will be reluctant to consider this credit line and will request formal confirmation that the credit will actually be granted.

In Luxembourg, banks could be considered liable if they continue to grant credit to an insolvent company and they have artificially delayed the insolvency declaration (abusive lending concept).

### How is the company placed into bankruptcy?

The bankruptcy is declared by means of a judgement rendered by the Court.

The bankruptcy judgement of the Court appoints a bankruptcy trustee (*curateur*) and a *juge-commissaire* chosen amongst the members of the Court to supervise the bankruptcy proceedings.

Officially, the bankruptcy trustee could be chosen from either the list of liquidators instituted by the Government or among the people who will offer the most guarantees for the diligence and the fidelity of their management. In practice, they are almost always chosen from the list of lawyers admitted to the bar. For major bankruptcies, the Court may from time to time decide to appoint one lawyer and one auditor.

### Does the concept of a preference period (*période suspecte*) exist?

The judgement concerning bankruptcy will set a date prior to the bankruptcy decision from which the company will be deemed to have been insolvent and have suspended its payments (*cessation des paiements*). The period from the date as determined until the bankruptcy judgement is referred to as the 'preference period'.

In practice, the preference period is systematically fixed six months prior to the bankruptcy judgement, even if a shorter period could be ruled by the Court.

## 03 Bankruptcy proceedings for commercial companies

During this period plus ten days, some transactions can be disputed by the bankruptcy trustee.

### What types of transactions can be cancelled or set aside when a company is placed into bankruptcy?

The following transactions will be declared null and void if they were undertaken during the preference period:

- disposition of the assets without consideration of material adequacy;
- payments of debts, which had not fallen due, whether the payment was in cash or by way of assignment, sale, set-off, or by any other means;
- payments of debts, which had fallen due, by any means other than in cash or by bills of exchange, and
- mortgages granted to secure pre-existing debts.

Any other payments made by the debtor that have fallen due and any other transactions entered into during the preference period will be declared null and void if the bankruptcy trustee (*curateur*) is able to prove that the persons receiving payment from the debtor or the persons entering into a transaction with the debtor had known of the cessation of payments.

Finally, there is a general principle that all acts or payments made to defraud the creditors will be declared null and void, regardless of the date when they were made.

The provisions of the law on financial collateral arrangements dated 5 August 2005 (the 'Collateral Law') allows a creditor to register financial collateral until the day of the bankruptcy proceedings but before the Court decision opening this proceeding. Therefore, a pledge granted during the preference period is valid and enforceable.

### What is the role of the bankruptcy trustee?

The bankruptcy trustee's role is not to manage the bankrupt company on a going concern basis but to realise the assets of the company and to pay off its debts to the largest extent possible. The assets of the bankrupt company will be managed by the bankruptcy trustee and divided between the creditors, taking into consideration their privileges and rank.

The bankruptcy trustee acts for the benefit of both the bankrupt company and each and every creditor. He/she will be responsible for hearing the directors of the company and will need to inform the public prosecutor of any misconduct amongst them.

### How is the bankruptcy made public?

Creditors are notified of the bankruptcy via publication in two local newspapers within three days of the bankruptcy judgement. In practice, they can also directly receive or request information from, or to, the bankruptcy trustee.

## The bankruptcy trustee's role is not to manage the bankrupt company on a going concern basis but to realise the assets of the company and to pay off its debts to the largest extent possible.

### Is there a creditor's committee that has a say in relevant decisions?

Such a committee can be appointed by the Court. The law foresees that creditors with the highest claims against the company are assigned seats on such a committee.

However, it is not usual practice to have such a committee in Luxembourg, except for major companies or in the financial sector. The committee has a purely advisory function and will assist and supervise the trustee in bankruptcy operations.

### How do creditors lodge their claim when the company is placed into bankruptcy?

Creditors must make a declaration of their claims at the Court's clerk office (*greffe*) within a period not exceeding 20 days from the date of the bankruptcy judgement, although in practice, creditors can declare their claims until the statement of closure of the claims verification (*procès-verbal de clôture de vérification des créances*).

The claims are verified by the bankruptcy trustee and by the *juge-commissaire*. Either the claim is accepted or rejected. In such a case, the bankruptcy trustee will request the Court to hold a hearing to discuss the claim with creditors.

### Can secured creditors enforce their security?

Creditors who have securities such as pledges and mortgages, which have been validly instituted before the bankruptcy judgement, are entitled to enforce their secured claims notwithstanding the bankruptcy.

Subject to certain conditions, the same principle applies for reservation of title clauses (*clauses de réserve de propriété*) in sales agreements of movable property.

### What is the ranking of claims?

All creditors whose claims compete in the bankruptcy constitute the group of creditors (*masse des créanciers*), except creditors who benefit from a mortgage or pledge under Collateral Law that are considered 'out of the group' as they may enforce such security and, therefore, do not compete with the other creditors.

The bankruptcy trustee shall pay the creditors in respect of the rank of privileges and charges provided for by the law after deduction of the bankruptcy trustee's fees and the administration costs of the bankruptcy, in the following priority order:

- Super-privileged salaries (last 6 months wages amounting to a maximum of six times the minimum social salary).
- Employees contribution to social security.
- Taxes (direct and indirect).

## 03 Bankruptcy proceedings for commercial companies

- Employer's contribution to social security.
- Landlord, pledgor not under Collateral Law and vendor's privilege.
- Unsecured debts.
- Subordinated debts (such as shareholders' loans).

### To what extent are creditors able to exercise rights of set-off vis-à-vis a bankrupt company?

The bankruptcy trustee would apply legal set-off during the bankruptcy procedure if:

- two debts (the debt towards the creditor and the one towards the bankrupt company) became liquid and has fallen due before the bankruptcy judgement, or
- two debts are directly connected to the same agreement or have the same origin.

According to Collateral Law, set-off during insolvency proceedings between mutually owed claims and/or financial instruments are valid and opposable to third parties, debtor, commissioner, bankruptcy trustee and liquidator. This is irrespective of their due date and their objects. However, they must comply with certain conditions; especially if they should result from a contractual set-off agreement between two or more parties.

### What is the outcome for contracts when the company is placed into bankruptcy?

Except for employment agreements which are terminated with immediate effect, the bankruptcy trustee must comply with the Luxembourg law and the specific terms and conditions of the agreement in order to terminate all other contracts concluded by the bankrupt company to avoid liability vis-à-vis the co-contracting party.

### Can the directors be held liable when a company is placed into bankruptcy?

The liability of directors is based either on the Company Act, the Luxembourg Commercial Code or the Luxembourg Civil Code.

According to the Company Act, a company may launch an action against one of its directors for wrong execution of the power granted to him/her and for any misconduct in the management of the company's affairs when it is evidenced that:

- i) he/she committed a fault constituting a contractual breach of his/her office;
- ii) the company suffered a damage, and
- iii) there is a causal link between the committed fault and the suffered damage.

The same conditions apply for liability in tort under common law rules.

## The liability of directors is based either on the **Company Act**, the Luxembourg Commercial Code or the Luxembourg Civil Code.

The decision to initiate a legal action against the director is taken by the general shareholders' meeting or the sole shareholder as the case may be. However, creditors may also act in the name and on behalf of the company if the company fails to do so and if such failure harms the creditors. If the company has been declared bankrupt, the proceedings will have to be initiated by the bankruptcy trustee.

The Company Act also provides that the directors are jointly and severally liable towards the company and any third party for damages resulting from the violation of the Company Act or the Articles of Association of the company.

According to the Luxembourg Commercial Code, the directors may be subject to additional liability if the company is placed into bankruptcy:

- The Court can decide that any shortfall in the company's assets is made up from the personal assets of the directors, jointly or severally, when the directors' gross negligence or willful misconduct has led or contributed to the bankruptcy.
- The bankruptcy may be extended to a member of the management board of the company who acted, for instance, under cover of the company in his/her personal interest to the extent that the latter by acting, can be considered as a tradesman and that he/she fulfils the bankruptcy's conditions.

- Directors can be condemned as *banqueroutier simple* (simple bankrupt) for **wrongful trading** or as *banqueroutier frauduleux* (fraudulent bankrupt) for fraudulent misconduct which are criminal offences being subject to a fine and/or imprisonment.
- A director may be prevented from carrying out another commercial activity if he/she has contributed to a serious and blatant offence leading to the bankruptcy.

**Wrongful trading:** When the directors knew or ought to have known that the company could not realistically avoid bankruptcy, they may be held liable for wrongful trading. If the directors then fail to take steps to file a petition for bankruptcy, and instead continue the business and, therefore, worsen the position of the company, then they can be held liable to make a contribution to the assets of the company and commensurate with any further losses incurred. It has, however, to be pointed out that this concept is not equivalent to the concept of wrongful trading as defined in the UK Insolvency Act.

## 03 Bankruptcy proceedings for commercial companies

### CRIMINAL LIABILITY

### CIVIL LIABILITY

### REGULATORY LIABILITY

	simple bankrupt / wrongful trading (573 à 576 Cco) fraudulent bankrupt (577 + 578 Cco)	extension of the bankruptcy to the directors (495 Cco)	debts supported by directors (495-1 Cco)	criminal liability happening without any bankruptcy (162 to 173bis Company Act)	tort liability		contractual liability	prohibition to carry out any business activity 444-1 Cco
					1382 + 1383 Cciv	59§2 + 192 Company Act	art 59 §1 (actio mandati) and 59§2 + 192 Company Act	
AGAINST WHOM	any directors even de facto directors fraudulent creditors	any directors even de facto directors	any directors even de facto directors	any directors even de facto directors	third parties and directors	any directors even de facto directors	any directors even de facto directors	any directors even de facto directors
BY WHOM	bankruptcy trustee public prosecutor	bankruptcy trustee public prosecutor	bankruptcy trustee public prosecutor	bankruptcy trustee public prosecutor	bankruptcy trustee third parties with personal interest	bankruptcy trustee third parties with personal interest	bankruptcy trustee	bankruptcy trustee public prosecutor
PRESCRIPTION	3 years (offence) or 10 years (criminal offence in case of fraud)	6 months from the bankruptcy judgment for individuals	3 years from the verification of claims	3 years (offence) or 10 years (criminal offence in case of fraud)	30 years from the knowledge of the fact	5 years from the fact	5 years from the fact	3 years from the bankruptcy judgement
CONDITIONS	personal expenses, unfaith postponing of the bankruptcy, favoring of a creditor, false bookkeeping, late filing of the petition for bankruptcy, fraud	conduct business in an personal interest / abuse of corporate assets	insufficiency in the assets	failure to ensure that mandatory publications are made or to submit the annual accounts to the general shareholders' meeting within 6 months after the closing of the financial year	fault or gross negligence damage	(i) breach of the Company Act or breach of the Articles of Association, (ii) damage (separate from the one suffered by the Company) and (iii) causal link	59§1 Company Act (i) management fault linked to the general duty of care, (ii) damage and (iii) causal link	contributed to the bankruptcy by gross negligence or fault
		pursues wrongly, in his personal interest, a deficit which could only lead to the cessation of the company's payments	by those who have been declared as conducting serious errors and are characterized as having contributed to the bankruptcy.	distributing fictitious dividends under certain conditions, forgery of the annual accounts or other mandatory books of the company and - appropriation of company assets	causal link		59§2 Company Act (i) breach of the Company Act or breach of the Articles of Association, (ii) damage and (iii) causal link	no registered office, late filing of bankruptcy, no payment of tax or social debts of the company

## To resign or not to resign.

### Directors' guidelines

When a company's solvency is questioned, the following steps are crucial for directors:

- Obtain regular professional legal and accountancy advice from established practices in the area;
- Annual accounts must be prepared within a 6 month period as of the closure of the corresponding financial year. These must be submitted to the shareholders for approval and publication within one month;
- Envisage methods of refinancing when a company is facing financial difficulties which might lead to insolvency, i.e. through an increase of capital, the sale of assets held by the company or repayment of due debts like a working capital loan;
- Evaluate and obtain advice for specific insolvency procedures including the COMI shift of § 3.2.;
- Directors need to consider whether they have a conflict of interest, if for example, they play a part on several boards (multi tier structure) or if they occupy dual roles that expose them to disclose confidential information that they have a duty to share with co-directors;
- Any resignation could have a reverse effect as it could be considered as a management fault. Any acknowledgement of the directors' resignation and the appointment of new directors in the meantime may be voted during the shareholders meeting in order to avoid any further liability;
- Board meetings should be held regularly and be fully recorded. They must include all the details surrounding the financial situation, invitation of external persons (such as a deal maker or a board member of the operational company that faces difficulties, lawyers and auditors);
- Shareholders' information where there are financial troubles, general shareholders meetings should be convened regularly to obtain either:
  - Discharge of the contractual liability of directors, **or**
  - Ratification by the shareholders in the course of a shareholders' meeting or circular resolutions.
- Do not incur new liabilities when there is no reasonable prospect of being able to pay;
- Consider the decision to stop trading or not;
- Check each month if the two cumulative conditions of the bankruptcy are met or not.

## 03 Bankruptcy proceedings for commercial companies

### Criminal liability of legal entities (law dated 3 March 2010)

This new law in Luxembourg establishes criminal liability of legal entities when a crime or an offence is committed in its name and in its interest by one or more of its statutory bodies. The aim of the law is reflected in the new article 34 in the Criminal Code.

Cumulative conditions for seeking criminal liability of legal entities:

1. A tort or a crime committed by one of its statutory bodies or one or more of its directors (according to law or *de facto*), and
2. A tort or a crime committed in the name and in the interest of the legal entity.

The criminal liability of the legal entity does not replace the criminal responsibility of individuals who have committed crimes. These liabilities can be cumulatively triggered.

A legal entity as well as the individual may be subject to prosecution, without the principle of *non bis in idem* being undermined, therefore, the criminal provisions mentioned in the table on page 16 are applicable *mutatis mutandis* to legal entities.

### What provisions apply to the sale of assets of the bankrupt company?

Non-perishable assets, except buildings, are sold by the bankruptcy trustee with the authorisation of the Court which will determine the conditions of the sale following a report of the *juge-commissaire* and subject to the consent of the debtor.

Buildings are normally sold through an auction, but could be sold by private notarial deed. In both cases, the bankruptcy trustee must obtain consent from the debtor and the authorisation from the *juge-commissaire*.

### How are bankruptcy procedures closed?

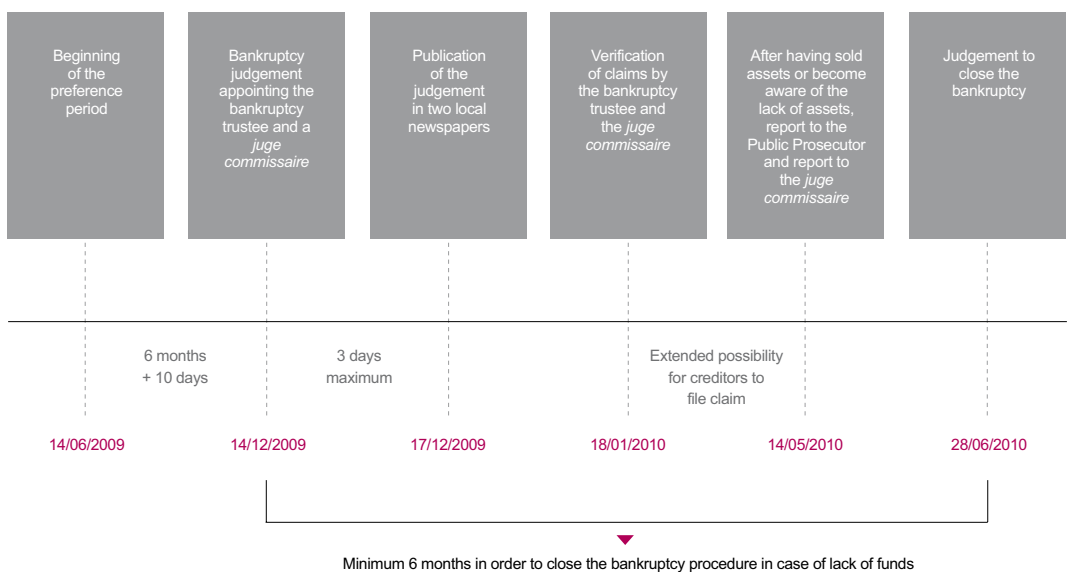
An application is filed with the Court by the bankruptcy trustee once all assets have been realised and the funds received have been distributed to the creditors taking into account their rank for privilege ones and *pari passu* for the other ones. Where there is a lack of funds (*insuffisance d'actifs*), it has to be acknowledged by the *juge-commissaire*. The Court will then declare the bankruptcy closed.

### Do 'out of Court' restructuring options exist?

There are neither formal legal procedures in Luxembourg to prevent a company to be declared bankrupt nor provisions organising the restructuring of debts through any formal transaction with creditors that would force them to accept and concur to such restructuring. The only possibility is free contractual arrangements but they will not be homologated by the Court and, therefore, they would not be automatically opposable to a third party.

**As an increasing number of insolvencies today involve more than one jurisdiction,** the EC Regulation 1346/2000 on Insolvency Proceedings ('Council Regulation') has introduced a framework within which the different insolvency regimes in the EU can interact.

#### Standard timeline for bankruptcy proceedings



### 3.2. CROSS-BORDER INSOLVENCIES

As an increasing number of insolvencies today involve more than one jurisdiction, the EC Regulation 1346/2000 on Insolvency Proceedings ('Council Regulation') has introduced a framework within which the different insolvency regimes in the EU can interact.

The Council Regulation came into effect on 31 May 2002 to codify how a member state should determine whether it has jurisdiction to open insolvency proceedings. It also provides a more uniform stance to the governing law which is applicable to those proceedings and recognises the principle of universality.



## 03 Bankruptcy proceedings for commercial companies

Under the Council Regulation, the notion of COMI is the keystone to determine the proper forum for the commencement of a 'main' insolvency proceeding and the administration of the assets of a single debtor spanning more than one jurisdiction. However, the stumbling block is that the Council Regulation has not addressed the concept of COMI in the context of insolvencies involving a multinational corporate group as it does not apply to the parent or subsidiaries of the debtor but only to branches.

The European Court of Justice ('ECJ') has tried to circumvent this problem in a manner that was functionally equivalent to a group consolidation or joint-proceeding, thus disregarding the rebuttable presumption that the COMI of foreign subsidiaries should be tied to the location of their registered office but acknowledging that the COMI is located for each entity at the place where the debtor conducts the administration of his/her interests on a regular basis and is, therefore, ascertainable by third parties. Despite the principle of universality applying to insolvency proceedings, the Council Regulation allows also the opening of secondary proceedings in another member State where the debtor has an establishment in order to protect local creditors especially employees rights. Such secondary proceedings are limited to the assets located in that State.

With the Centros case, the ECJ has opened the door for a free choice of the applicable insolvency proceedings achieved through COMI shifts. It specifies that the national courts may, on a case by case basis, take abuse or fraudulent conduct into account when assessing the reach of freedom of establishment. Even if a shift of the COMI is, in principle, not abusive, there is a restriction to the freedom of establishment where general interest (such as protection of workers and creditors) has to be protected or if the COMI shift is undertaken exclusively in order to harm legal rights.

Until now, Luxembourg case law has only ruled a few questions regarding COMI and the opening of secondary proceedings, but it notably emerges from the case law that the courts recognise without any difficulties the principal proceeding opened in another member state and open secondary proceedings in Luxembourg. Further, the courts also had to decide on the validity of the COMI's transfer and it appears that recent Luxembourg case law is in line with the decisions held by the ECJ. Indeed, Luxembourg case law has been consistent in demonstrating that the courts rebut the presumption in favour of the registered office if it appears that the subsidiary is a letter box company.

**Even if a holding company is located in Luxembourg,** its groups' main interests may be abroad and its effective managers may not necessarily be based in Luxembourg.

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Contrary to the UK, Luxembourg has not yet adopted the **UNCITRAL** Model Law on Cross Border Insolvency.



#### **1997 - UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment**

Adopted by UNCITRAL on 30 May 1997, the Model Law is designed to assist States to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively instances of cross-border insolvencies. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place. The Model Law respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law. It offers solutions that help in several significant ways, including: foreign assistance for an insolvency proceeding taking place in the enacting State; foreign representative's access to courts of the enacting State; recognition of foreign proceedings; cross-border cooperation, and coordination of concurrent proceedings.

## 04 Special provisions for credit institutions and 'PFS'

**Luxembourg, like most other EU countries has been affected by the crisis affecting financial conglomerates, particularly those with substantial subsidiaries in Luxembourg such as Dexia, Fortis, Kaupthing, Glitnir, Landsbanki or even Lehman Brothers.**

As the share price of these banks has dramatically deteriorated since the downturn, restructuring has been a key focal point leading to substantial financial assistance from the public and private sectors and/or intervention by the national authorities.

BNP Paribas, for example, took a majority stake in Fortis Bank, Luxembourg while, in respect of Dexia's financial difficulties, several measures were taken by the French, Belgian and Luxembourg authorities. Following a decision taken by Dexia's Board of Directors on 30 September 2008, Dexia subsequently increased its capital by EUR 6.4 billion. Public and private investors from Belgium and France subscribed EUR 3 billion each and the Luxembourg State subscribed EUR 376 million under the form of convertible bonds.

Aside from those cases where the Luxembourg authorities facilitated the banks' restructuring through financial measures, in the Glitnir, Kaupthing and Landsbanki's cases, Luxembourg's national authorities used a scheme specifically provided for under legislation (i.e. suspension of payments) and appointed administrators.

However, the outcome of the suspension of payments was not the same for these three Icelandic banks.

Following Landsbanki's suspension of payments, the Court ordered the judiciary dissolution and the winding-up of Landsbanki, Luxembourg S.A. on 12 December 2008.

In the case of Kaupthing in a judgement delivered on 8 July 2009, the Court ratified the second restructuring plan drawn up by the administrators of Kaupthing Bank, Luxembourg S.A. (the first of which was rejected by the interbank creditors on 16 March 2009). This plan provides for the split of Kaupthing Bank, Luxembourg S.A. into two new entities: Banque Havilland S.A. to undertake banking activities and Pillar Securitisation S.à.r.l. to hold any loans previously held by Kaupthing Bank, Luxembourg S.A.

Regarding Glitnir Bank, Luxembourg S.A., a restructuring plan prepared by its administrators was submitted to the vote of the bank's creditors. This has subsequently been approved pursuant to a decision by the Court on 1 April 2009. Within the restructuring plan, it has been noted that all creditors, except the Central Bank of Luxembourg (CBL), will be integrally reimbursed and that the CBL will also be reimbursed but not immediately. According to the plan and following an extraordinary general meeting of shareholders on 3 April 2009, the bank entered into voluntary and solvent winding up proceedings.

## By supervising the financial sector, the CSSF is playing a key role in the prevention of insolvencies in respect of banks or PFS.

### What are the applicable laws?

In Luxembourg, the liquidation of credit institutions is ruled by the articles 60 and 61 of the law of 5 April 1993 on the financial sector which has been modified by the law of 19 March 2004, implementing in Luxembourg the Reorganisation and Winding Up Credit Institutions Directive, (2001/24/EC), hereafter the '1993 Law'.

### How does the CSSF prevent insolvency?

The *Commission de Surveillance du Secteur Financier* ('CSSF') is the Luxembourg financial sector's regulatory authority. It plays an important role in the prudential supervision of credit institutions and Professionals of the Financial Sector ('PFS'), hereafter collectively 'Establishments' established under Luxembourg law. The CSSF's prudential supervision also extends to any business carried out by such institution or firm in another EU member state or outside the EU whether by means of the setting up of a branch or by way of the provision of services.

By supervising the financial sector, the CSSF is playing a key role in the prevention of insolvencies in respect of banks or PFS. Following directives 2006/48/EC, the so-called Capital Requirements Directive and 2006/49/EC, the Capital Adequacy Directive and the guidelines edited by the Committee of European Banking Supervisors ('CEBS'), the CSSF has put in place several measures through circulars in view of:

i) Reviewing and evaluating banks' exposure to any risks;

ii) Adequacy and reliability of the banks' own funds;

The CSSF carefully follows the financial situation of banks, which implies amongst others, the following rights:

i) The right to investigation, even with the help of auditors;

ii) To oblige Establishments to hold own funds in excess of the minimum level;

iii) To require the reduction of risk inherent in the activities, products and systems of Establishments;

iv) To enjoin Establishments to remedy, within a defined period, the situation found to exist, and

v) If, by the end of the period prescribed by the CSSF the situation in question has not been remedied, the CSSF may suspend the pursuit of the Establishment's business.

Finally, the CSSF can, at any time, withdraw the Establishment's authorisation if it is unable to face its financial obligations vis-à-vis its creditors or if it no longer meets the required conditions provided by laws and regulations. This withdrawal unavoidably leads to liquidation.



## According to article 60-1 of the 1993 Law, the suspension of payments procedure applies to Establishments which manage funds for third parties.

Indeed, according to the legal provisions in force at that time, it was a 'professional acting for its own account' and, as such, the suspension of payments procedure was not applicable to it. Such decision was taken by the court as the procedure of suspension of payments was the most appropriate under the circumstances of the case and it adopted a pragmatic approach by allowing such procedure to take place.

Another case law in 2008 also limited the scope of suspension of payments to an Establishment that temporarily ceased to pay its creditors but had enough assets to reimburse all creditors in principal including interest.

### Who may apply for suspension of payments?

Only the CSSF or the Establishment, after having informed the CSSF, are entitled to apply for suspension of payments.

### What happens during the period between the application and the Court's decision ruling the suspension of payments?

All payments are suspended. When the application by the Establishment or the notification made by the CSSF is lodged, this prohibits the Establishment from taking any act other than precautionary and protective measures unless authorised by the CSSF or by any contrary legal provision.

Any member of an administrative, executive or management body who contravenes such legal provisions may be condemned by criminal sanctions and any contravening act would be void and null. The CSSF acts as administrator until the point when the judgement appointing an administrator is held.

### What is the applicable procedure in case of suspension of payments?

This request is lodged with the Court that has to render a decision within a short period of time (in 2009, in two well-known cases, the Court has taken its decision within two calendar days).

The decision is subject to appeal before the Court of Appeal within 15 calendar days from the notification of the judgement by a bailiff. The appeal does not have any suspensive effects. Opposition and third opposition are not allowed.

The Court appoints one or several administrators to control the management of the Establishment's assets and its use. In such judgement, the Court may define some duties owed by the administrator as follows:

- To list all the assets and liabilities of the Establishment.
- To determine if a reorganisation of the Establishment is foreseeable.

## 04 Special provisions for credit institutions and 'PFS'

- If the reorganisation is possible: to prepare a reorganisation plan taking into account the rank of privileges to be approved by the majority of creditors.

In such cases, the suspension of payments may lead to the homologation of a reorganisation plan and not to a judiciary liquidation.

No provision is contained in the 1993 Law regarding a recovery plan during the suspension of payments procedure. A decision held in 2009 by the Court of Appeal regarding a reorganisation plan submitted for approval to the creditors of the Luxembourg subsidiary of Kaupthing Bank during its suspension of payments procedure laid down several principles in this respect. The Court of Appeal decided that the administrator is entitled to determine the content of the reorganisation plan. It is also stated in this decision that it could be inspired by the rules applicable to a controlled management procedure when asserting the legacy of the arrangements undertaken during the suspension of payments procedure. The judges decided that the reorganisation plan could be approved even if the administrators have not obtained an unanimous approval of all creditors but if more than half of the votes of the restructured interbank creditors, representing together more than half of the liabilities represented by the restructured debt approved it.

### What is the maximum duration of the suspension of payments procedure?

Six months. After this period, either the Establishment is reorganised or liquidated. No postponement is foreseen by the 1993 Law. However, in a 2009 case, the Court extended the duration of the suspension of payments (initially 6 months), in view of the creditors' interest, by another two month period.

### Who may apply for judiciary winding-up?

Only the Public Prosecutor and the CSSF may apply for an order for the dissolution and winding up of an Establishment. It means that neither the creditors nor the Establishment are entitled to do so.

### Special effects common to suspension of payments and judiciary winding-up

Both procedures shall not affect;

- (i) rights in rem of creditors;
- (ii) the seller's rights based on a reservation of title;
- (iii) the rights of creditors to demand the set-off of their claims against the claims of the Establishment.

## When an Establishment is wound up, its authorisation is permanently withdrawn.

### Under what circumstances can an Establishment be judiciary wound up?

An Establishment may be dissolved and wound up where:

- (i) After a suspension of payments' period, it is apparent that no reorganisation plan would be able to rectify the situation which caused the suspension of payments.
- (ii) The financial situation of the Establishment is undermined to such an extent that it can no longer meet the commitments which it owes to all its debtors, obligees and holders of participatory rights.
- (iii) The CSSF has withdrawn the authorisation granted to the Establishment and the decision to withdraw has become final and definitive.

### Effect of the judiciary winding-up

The judiciary liquidation judgement is immediately enforceable prior to registration and notwithstanding any appeal to such decision.

When an Establishment is wound up, its authorisation is permanently withdrawn.

However, the withdrawal of authorisation does not prevent the liquidator from carrying out some of the Establishment's activities necessary or appropriate for the purpose of the winding-up with the consent and under the supervision of the CSSF.

### Procedure of judiciary winding-up

When ordering the winding up, the Court appoints a *juge commissaire* and one or more liquidators (usually a lawyer and an independent auditor).

The Court will determine how the winding-up will be carried out and whether the rules governing bankruptcy to some extent apply.

In principle, the Court will apply the main commercial bankruptcy rules and specify other ones such as the following (but without being exhaustive):

1. The removal of the Establishment's management and controlling bodies.
2. The appointment by the *juge commissaire* of a creditors' committee to assist and supervise the work performed by the liquidators. The latter will not have any decisional powers.
3. The date considered by the Court as the date of inability to pay debts (6 months before either the date of the judgement ruling the suspension of payment or the date of the judgement ruling the judiciary winding-up if this procedure does not follow a suspension of payment).

## 04 Special provisions for credit institutions and 'PFS'

4. The procedure to verify the claims.
5. The distribution of interim dividends as well as the interim presentation of accounts.
6. The frequency for the liquidators to report to the *juge commissaire*.
7. The strict separation of fiduciary assets

### Ending of the judiciary winding-up

Experience shows that closing the winding-up will normally take several years.

The Court decides on the closure of the judiciary winding-up after having heard the liquidators' report duly approved by the *juge commissaire*.

#### **AGDL - Luxembourg Deposit Guarantee Association**

Members of the AGDL, all the credit institutions (banks) and all the investment firms are listed in the table of investment firms kept by the CSSF.

The purpose of the AGDL guarantee is to protect, in case of insolvency of a member of the association, (i) all the depositors in cash by guaranteeing them a reimbursement of up to EUR 100.000, (ii) all the investors by guaranteeing them a reimbursement of their claims arising from investment operations, up to the amount of EUR 20.000.

### Rules applicable to cross-border insolvency proceedings

Establishments with a registered office in Luxembourg and having branches located outside Luxembourg are governed by Luxembourg's law with regards to insolvency proceedings.

#### *Luxembourg branches of EU Establishment*

Reorganisation and winding-up measures decided by the authorities in the location where the Establishment has its head office are fully effective in Luxembourg in accordance with the legislation of the home State for the Luxembourg branch of this Establishment.

Where the CSSF implements a reorganisation measure relating to a branch of a EU Establishment, it must without delay inform the competent authority of the home member State, and cannot start any specific procedure but must wait for the decision of the authorities of the home member State to start a reorganisation procedure applicable in the home State. There are no similar provisions for the winding-up of the Luxembourg branch.

# Host or Home Country responsibility.

## Regulation and Supervision of Financial Markets in the EU

	PRUDENTIAL SUPERVISOR	DEPOSIT INSURANCE REGULATOR	REORGANISATION AND WINDING-UP AUTHORITY
<b>BANKS LEGALLY INCORPORATED</b>			
PARENT BANKS AUTHORISED IN HOME COUNTRY	Home country authorising parent bank (consolidated supervision = solvency)	Home country	Home country
SUBSIDIARIES OF PARENT BANKS HEADQUARTERED AND AUTHORISED IN A ANOTHER EU COUNTRY	Home country authorising parent bank (consolidated supervision – solvency) Host country authorising the subsidiary ("solo" basis)	Host country	Host country
SUBSIDIARIES OF PARENT BANKS HEADQUARTERED AND AUTHORISED IN A NON-EU COUNTRY	Host country authorising the subsidiary	Host country	Host country
<b>BRANCHES</b>			
BRANCHES OF BANKS HEADQUARTERED AND AUTHORISED IN OTHER EU COUNTRY	Home country of head office (consolidated supervision – solvency) Host country (Liquidity)	Home country (possibility of supplementing the guarantee by host country)	Home country
BRANCHES OF BANKS HEADQUARTERED AND AUTHORISED IN A NON-EU COUNTRY	Host country	Host country if cover provided by home country is not equivalent to that prescribed by directive	Host country in case that the foreign bank has branches in more than one Member State

# 04 Special provisions for credit institutions and 'PFS'

## Luxembourg branches of non-community establishment

Reorganisation measures or judiciary liquidations which are held in the home State in which the Establishment has its head office are fully effective in Luxembourg, without any further formalities.

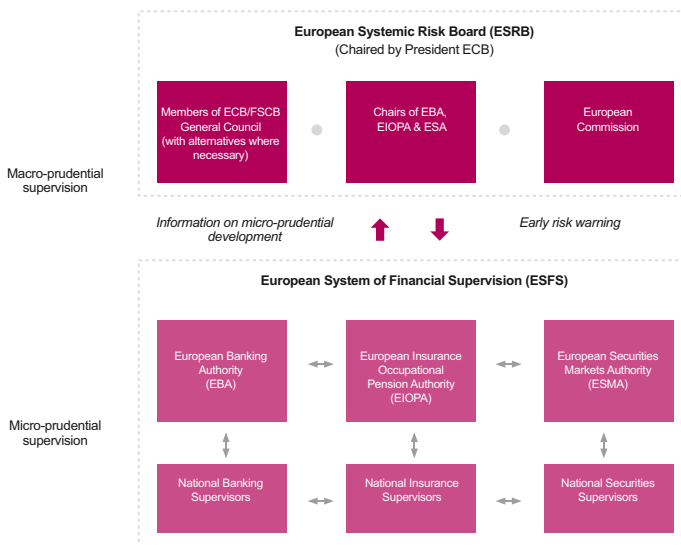
It should nevertheless be emphasised that the Luxembourg Court has jurisdiction to declare a suspension of payments or judiciary liquidation in respect of a Luxembourg branch of non-Community Establishment. This provision has been foreseen to preserve the interests of creditors of the Luxembourg's branch. The non EU head office is not entitled to lodge an application for suspension of payments; indeed, solely the CSSF is competent for doing so.

## **New development within the financial sector to prevent systemic insolvency risk**

The Commission articulates a new framework with two levels of supervision:

1. The micro-prudential supervision which supervises financial institutions on an individual basis;
2. The macro-prudential supervision focusing on the stability of the financial system as a whole. It aims to mitigate the systemic risk and relies on macro-economic indicators.

## The future of EU financial architecture



## 05 Special provisions for 'UCITS'

The fall of Madoff and his Ponzi scheme has significantly contributed to an upheaval of the funds landscape. In a press release dated 23 January 2008 issued by the CSSF, 18 funds or sub funds are cited to have been affected by the Madoff fraud. In 2009, the judiciary liquidations of three funds (Herald (Lux) SICAV, Luxalpha SICAV and Luxembourg Investment Fund SICAV) were ordered by the Court on basis of the law of 20 December 2002 (the '2002 Law').

Together, these events have turned the spotlight back on a number of issues within the funds industry including the role and responsibility of the custodian bank. These events have thus triggered the need to pin down new measures for establishing how the situation has in fact been handled whilst also identifying how we progress into the future.

In Luxembourg, the ALFI Madoff Task Force ('AMTF') was established to assess the impact of the fraud and involved interaction with experts in Luxembourg and abroad including investor representatives in key distribution markets for Luxembourg domiciled UCITS funds. The report cited two main messages received from the parties interviewed, namely the strengthening of investor protection and the clarification of the role and responsibilities of the depositary, which can vary across States.

The ALFI code of conduct has too been reviewed in light of these events and presents the option to *"harmonise the depositary's responsibilities by imposing demanding standards on the depositary and to force the latter to become an all risks insurer has been put forward in the wider debate on the standard of liability applying to fund depositaries"*. The AMTF is of the view, however, that *"any possible future regulation will have to strike the balance between on the one hand, an adequate allocation of responsibilities amongst the various parties in the value chain, and, on the other hand, an adequate allocation of responsibilities amongst the various parties in the value chain (e.g. depositary, CSDs, asset manager, management company, distributor...)"*.

It was noted in the analysis, however, that *"Luxembourg legislation on fund depositaries faithfully reflects the provisions of European Council Directive 85/611/EEC (the UCITS Directive) and that Luxembourg has an appropriate framework for the protection of investment fund assets and investors, in line with applicable standards"*.

## 05 Special provisions for 'UCITS'

There is no doubt nonetheless, that greater harmonisation across EU states is needed. The forthcoming UCITS IV which is set to be launched in each European Member State by 1 July 2011 is a step by the European Commission in its project to create a genuine pan-European single market for investment funds. The draft UCITS IV Directive will introduce new regulations designed to reinforce the existing UCITS brand and ease the route for cross-border fund mergers and distribution. It is expected to bring greater harmonisation.

### What are the procedures provided by the 2002 Law?

Two different types of structures for collective investment schemes should be distinguished: incorporated investment companies (SICAV and SICAF, the 'UCI' and the contractual scheme (*Fonds Commun de Placement, the 'FCP'*)).

**FCP:** Any undivided co-ownership of securities managed in accordance with a risk principle spread between owners who have limited liability and whose rights are represented by units intended to be placed with the public.

Different rules apply for liquidation proceedings depending on the type of UCI.

For both investment companies and contractual schemes, the major types of dissolution are:

- (i) **Voluntary dissolution**, and
- (ii) **Judicial dissolution**.

**Voluntary dissolution of a UCI:** Voluntary dissolution may be granted to an investment company through a decision taken by the general meeting of shareholders, unless the liquidator acknowledges, after discussion with the CSSF, that it would be preferable for the company to be put into judicial liquidation. It should be noted that an extraordinary general meeting of shareholders must be held when the company's capital is below two-thirds or one quarter of the minimum capital. This proceeding implies also that the UCI is solvent.

### Consequences of the withdrawal of a SICAV or a SICAF from the CSSF's list

A withdrawal automatically leads to a suspension of payments of the UCI and a prohibition from taking any measures, other than protective measures, except by authorisation of a 'supervisory commissioner'.

The process by which the decision of the CSSF becomes final takes at least one month, as the CSSF withdrawal decision could be challenged before the administrative Court during this period.

In the meantime, a supervisory commissioner, (task which is performed by CSSF), advises, authorises any decision proposed to be taken by and participates in the meetings held by the management body.

## Only the Public Prosecutor, (ex officio or at the request of the CSSF), is allowed to request judicial liquidation.

After the period in which the administrative claim has elapsed, the Court pronounces formally the judicial liquidation of the UCI.

### Procedure of judicial dissolution

Under the 2002 Law, the judicial dissolution is restricted to three specific cases:

- When a UCI does not apply for registration with the CSSF within one month from the date of its incorporation;
- Where there is unconditional refusal by the CSSF of a UCI's registration, and
- When there is an unconditional withdrawal of a UCI's registration from the CSSF's list.

The Court may use its discretion and decide to apply the general law relating to commercial companies (voluntary liquidation of a solvent company) but, usually, the Court requests the combined application of commercial bankruptcy rules with some specific rules of the Company Act in relation to voluntary liquidation.

Once the judicial liquidation of the UCI is opened, the liquidator(s) appointed (for important cases - usually a lawyer and an independent auditor) analyse the situation, review creditors' claims, realise assets and pay debts.

The 2002 Law also expressly foresees that all seizures in favour of unsecured creditors are terminated and that all legal actions and enforcement procedures relating to movable or immovable assets are to be pursued, commenced or exercised against liquidators.

### Opening of judicial liquidation?

Only the Public Prosecutor, (ex officio or at the request of the CSSF), is allowed to request judicial liquidation.

The investors are not entitled to request a judicial liquidation but could always make an informal request to the CSSF to investigate ('ombudsman' function), thus enabling the CSSF to request the Public Prosecutor to act if the facts warrant it.

### Ending of judicial liquidation

The liquidator closes the judicial liquidation and, if possible, distributes to shareholders their due share in the net asset value of the liquidated company.

Thereafter, the auditors issue their report on the liquidation accounts to the Court, which in turn gives a ruling on the management of the liquidators and then closes the liquidation.

Experience shows that the judicial liquidation of UCIs takes years and can only be closed when all difficulties have been resolved.

## 06 Restructuring in view of closing activities in Luxembourg

**Restructuring has become a regular occurrence over the years and is often necessary to implement a process of strategic and financial change. This can involve many different stakeholders and their respective interests whilst providing real underlying improvements.**

Following the credit crunch, the financial markets have faced huge difficulties and lenders have become keen to find possible solutions to corporate failure. The first step has usually been the signature of moratorium or standstill agreements, thereafter negotiations between the lenders and distressed company might turn to various options such as enforcement of pledge, COMI shift (cf point 3.2. above), and debt equity swap.

### **Collateral law and enforcement of pledge as a restructuring tool:**

- Flexible procedures of enforcement.
- Full protection of the pledge against insolvency proceedings in Luxembourg and abroad.
- The pledge is valid and enforceable at all times against all third parties including all creditors, receivers or liquidators.
- Enforcement of pledge prevents the risk of the restructuring being challenged.

- Restructuring may be done with or without the agreement of the initial sponsors.
- The transfer of the group may be to a company controlled by the lenders, by the existing re-investing investors, by new investors or a combination of them.

In Luxembourg, the final step of a restructuration is either the bankruptcy or the voluntary liquidation and winding-up of a company as outlined below. The voluntary liquidation rules are included in the Company Act.

### **Under what circumstances can a company be put into voluntary liquidation?**

- The purpose (corporate object) of the company has no further relevance.
- The company's assets were sold, contributed or an IPO was realised.
- For tax reasons, the activities of the company have been moved to another location.
- The company is dormant and has to be deregistered.

## In Luxembourg, the final step of a restructuring is either the bankruptcy or the voluntary liquidation and winding-up of a company.

### What are the main legal steps of a voluntary liquidation?

Three shareholders' meetings are necessary, specifically:

1. The decision to dissolve and liquidate the company is taken by the shareholders during a shareholders' meeting held before a Luxembourg notary. At that time, the shareholders appoint a liquidator and determine its powers.

2. When the liquidation is completed, the liquidator convenes a second shareholders' meeting in order to approve the way the liquidation has been carried out and to appoint an auditor to the liquidation (*commissaire à la liquidation*).

3. A third general shareholders' meeting is then held in order to decide on the work performed by the liquidator and to close the liquidation process.

### What happens when two shareholders have an equal majority and one does not want to liquidate the company?

Application for dissolution of the company for just cause may be made to the Court upon request of shareholders or directors. This request shall be justified and the requesting party must prove that there is an important disagreement between the shareholders which will jeopardise the implementation of the corporate object of the company or jeopardize the company itself.

Further, this disagreement will mean that a liquidator cannot be appointed.

### What is the role of the liquidator?

The liquidator replaces the management organs of the company (which cease to exist from the date of entering into the liquidation) and can carry on all activities necessary for the effective liquidation, specifically:

- Realisation of the assets in order to make them liquid in the best interests of the company in liquidation, the creditors and the shareholders;
- Settlement of all debts and securities;
- Co-ordination of the establishment of the financial statements;
- Drawing-up of a final report on the mission of the liquidator;
- Distribution of the liquidation surplus and any advance, if necessary, after deep review of the financial situation, possible claims including representation and warranties given in the past for the sale of a subsidiary, and
- Review of the tax situation with the relevant administration in view of the final assessment of the company.

## 06 Restructuring in view of closing activities in Luxembourg

### What about interim distribution (advance made on liquidation surplus)?

The liquidator is entitled by law to make interim distributions or provisional payments during the liquidation period provided that all debts have been settled or subject to the condition that he/she deposits sums necessary for the payment of the unpaid debts, or has made sufficient provisions for the payment of debt, the amount of which will remain uncertain (e.g. tax, doubtful debts) until the closing of the liquidation.

The liquidator is personally liable where there is distribution of an advance on the liquidation process in breach of the above rule.

### What about the tax consequences of the liquidation for the liquidated company?

The shareholders' decision to dissolve the company has no direct consequences on the process of determination of the taxable basis and tax liability of the company and, the income received during the liquidation period is, in principle, taxed. However, the **participation exemption** contains a full tax exemption for dividend income as well as for capital gains income.

**Participation exemption:** Dividend and liquidation gains exemption on shareholdings of at least 10% or a cost of at least EUR 1,2 million held for an uninterrupted period of 12 months. Capital gains exemption of shareholdings of at least 10% or costs of at least EUR 6 million held for an uninterrupted period of 12 months.

From a compliance point of view, the decision to dissolve the company will result in the company having only one income tax and municipal business tax return to file with the Luxembourg tax authorities for the period from the previous financial year-end to the date of closing of the liquidation. However, if the liquidation period lasts more than three years, a tax return must be filed for each accounting year of the liquidation period. The liquidation profit is computed as the difference between the net assets as of the date of dissolution of the company and the net liquidation proceeds available for distribution, implying the realisation of all hidden reserves. The net assets as of the decision of dissolution will be equal to the closing net asset value of the previous financial year-end. It should, however, be noted that even when the three-year period has not been exceeded, and hence only one corporate income tax return should be filed, the company will continue to be liable to net wealth tax on 1 January every year throughout the entire liquidation period.

### How could the liquidator cover its own liability?

The liquidator will be liable, both to third parties and to the company, for the execution of his/her mandate and for any misconduct in the management of the liquidation.

Hold-harmless agreements are usually granted by the shareholders of the company to the liquidator, being considered that they do not protect against criminal liability or from liabilities in the event of gross negligence, fraud or willful misconduct.

## Each year the liquidator must convene a shareholders' meeting to present the results of the liquidation.

### Could the voluntary liquidation procedure be adopted when the company is insolvent?

As soon as the liquidator is aware of the financial situation, he/she has to perform the Luxembourg insolvency test. If the company is considered to be in a situation of bankruptcy, he/she files a petition for bankruptcy (*aveu de la faillite*).

### Who supervises the activities of the liquidator?

The auditor to the liquidation intervenes only at the end of the process. The auditor examines the report prepared by the liquidator as well as the supporting accounts and documents, and prepares an auditor's report to the final general shareholders' meeting.

Further, each year the liquidator must convene a shareholders' meeting to present the results of the liquidation. He/she must also present a statement outlining the reasons which have prevented completion of the liquidation.

### What about the tax consequences of the liquidation for the shareholders of the liquidated company?

Regarding the reimbursement of the share capital and the issue premiums to shareholders, they are exempt of any tax.

The *boni de liquidation* (the liquidation surplus after reimbursement of share capital and issue premium) is not considered, at the level of the company, as dividend (*revenus de capitaux mobiliers*). Consequently, the company will not be subject to any tax for this distribution and no withholding tax will, therefore, be levied at the level of the company.

At the level of the shareholders of the company, the Luxembourg qualification of the *boni de liquidation* is the following:

- If the shareholder is a resident joint-stock company, the *boni de liquidation* will have the same tax treatment as dividend; as a consequence, the *boni de liquidation* will be tax exempt if the company holds or undertakes to hold the said participation during an uninterrupted period of at least 12 months, and if, during that period, the participation rate never passes below 10% of the share capital of the participation, or the acquisition cost below € 1.200.000;
- If the shareholder is sole proprietorship (a business enterprise conducted by a single individual in contrast to a firm or limited liability company), the *boni de liquidation* will be considered as business income;
- In all other situations, the *boni de liquidation* will be considered as capital gains.

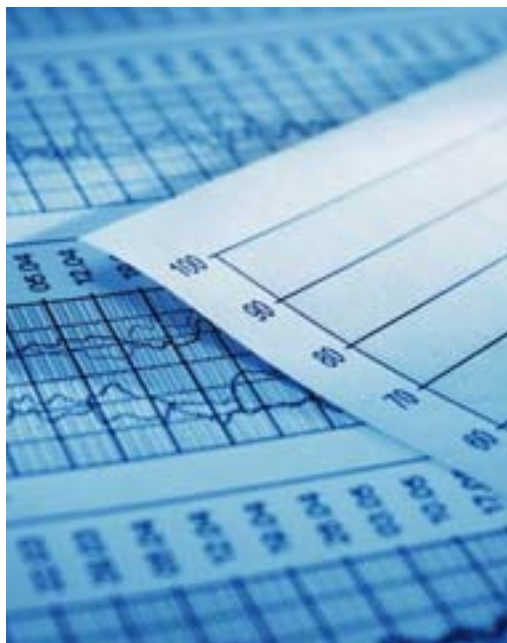
## 06 Restructuring in view of closing activities in Luxembourg

There is usually no specific article in the tax treaties in force between Luxembourg and partner countries that deals with the taxation of the *boni de liquidation*. However, the *boni de liquidation* being assimilated to capital gains in Luxembourg when received by non-resident shareholders, the applicable article in the double tax treaties is, in principle, the article dedicated to capital gains, i.e. the article corresponding to the article 13 of the OECD Model Convention.

### What happens after the liquidation process ends?

Following the third general shareholders' meeting, the dissolution and liquidation process is completed and the company is no longer a legal entity. However, the company's extinction is not absolute and the Luxembourg doctrine and case-law consider that the legal personality of the company is maintained during a period of 5 years (passive personality) from the publication of the closure of the liquidation during which the creditors who have not been satisfied may exercise actions against the liquidator, acting in such capacity.

The re-opening of the liquidation could take place during this 5 year period upon request of any interested party but only if the closure was made fraudulently to the rights of this party.



## 07 Our services

### 7.1. OUR SERVICES FOR BANKRUPTCY PROCEEDINGS

#### Bankruptcy Prevention

Our firm can assist with the analysis of various financial situations such as the failure to pay current liabilities out of current assets (giving advice in close corporation with auditors to verify if the test of bankruptcy is fulfilled).

Working closely alongside other teams within the firm including our banking & finance practice, we have vast experience across various restructuring matters and regularly advise and prepare tailored strategies for a broad range of clients.

We can provide high level support and advice in specialist areas including debt and equity financing, the safeguard of security interests and enforcement of security interests, financing arrangements for groups facing financial difficulties including negotiations with lenders as well as dealing with distressed M&A financings.

#### Bankruptcy Proceedings

We represent and provide assistance to creditors, shareholders or directors. We understand that each of these stakeholders can have a different perspective, for example, that the bankruptcy could allow the shareholder to refuse further funding of the business but it could also trigger the liability of a director who was simply too negligent.

Our firm can also prepare the file for the Court and file a petition for bankruptcy.

#### Cross-Border Insolvencies

Given the complex nature of corporate groups, their insolvencies can pose difficulties concerning jurisdictions. For example, where should insolvency proceeding(s) be filed and administered and in cases of conflict of law, which law should govern the proceedings? Does Luxembourg public order allow it to refuse enforcement of a foreign judgement, especially in case of failure to provide timely notice of proceedings to creditors?

## 07 Our services

Oostvogels Pfister Feyten has been a member of INSOL and the IBA for many years. It is quite often questioned on the interpretation of the Council Regulation especially to identify if debtor's COMI could be in Luxembourg or not or, to decide upon the law governing the avoidance of transactions.

### **Litigation**

Our litigation team intervenes in cases involving lenders' or managers' liability but also at the earlier stage where the company was unduly declared bankrupt in order to appeal or make an objection to the bankruptcy judgement.

### **7.2. OUR SERVICES IN VOLUNTARY LIQUIDATIONS**

#### **Strategic advice prior to the opening of proceedings**

As a first step, a structured approach is necessary to ensure that a voluntary liquidation is the most appropriate procedure.

### **Assistance during proceedings**

Our law firm can also support liquidators. In all circumstances, we will carry out the following:

1. Provide a general overview of the entire process as well as provide specific information on issues concerning legal and tax problems;
2. Co-ordinate operations, negotiate with the different parties involved with the liquidation;
3. Maintain an intermediary role between the shareholders and other intervening parties

### **7.3. PRIVATE EQUITY / FINANCIAL EXPERTISE**

We have a particular expertise with voluntary liquidations for private equity funds at the time of resale or at the listing of the target company(ies) and also for Establishments, funds or other professionals of the financial sector.

## 08 Our Law firm

Established in 1999, Oostvogels Pfister Feyten is one of Luxembourg's largest independent business law firms. We are internationally recognised for our capabilities in both restructuring & insolvency and advise a wide range of clients in the area ranging from financial institutions, corporate, private equity houses, foreign insolvency practitioners through to stakeholders and creditors. We advise on all aspects of corporate restructuring and insolvencies.

Where necessary, our team calls upon experts in other departments of the firm, specifically banking & finance, corporate, investment funds, private equity and tax to offer a comprehensive service to our clients' projects.

Specifically, we:

- Possess guarantees of the professional qualifications required;
- Have an excellent knowledge of the legal and regulatory context on a local, European and international scale. This is constantly updated through rich documentation and ongoing professional training;
- Offer an internationally-oriented team: As an international business law firm, we foster a multicultural team environment. Individuals with our restructuring & insolvency departments master a number of key languages including French, German and English.

We are a trustworthy partner offering a tailor-made service and day-to-day follow-up of the liquidation process. We always assist our clients attentively and are open to their particular needs. Our team maintains close relationships with regulators, intermediaries and international law firms to offer a comprehensive service with matters in insolvency and corporate restructuring.

## 09 Firm contacts

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## 10 Our offices



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