

**BANKRUPTCY AND A FRESH START: STIGMA ON FAILURE AND LEGAL
CONSEQUENCES OF BANKRUPTCY.**

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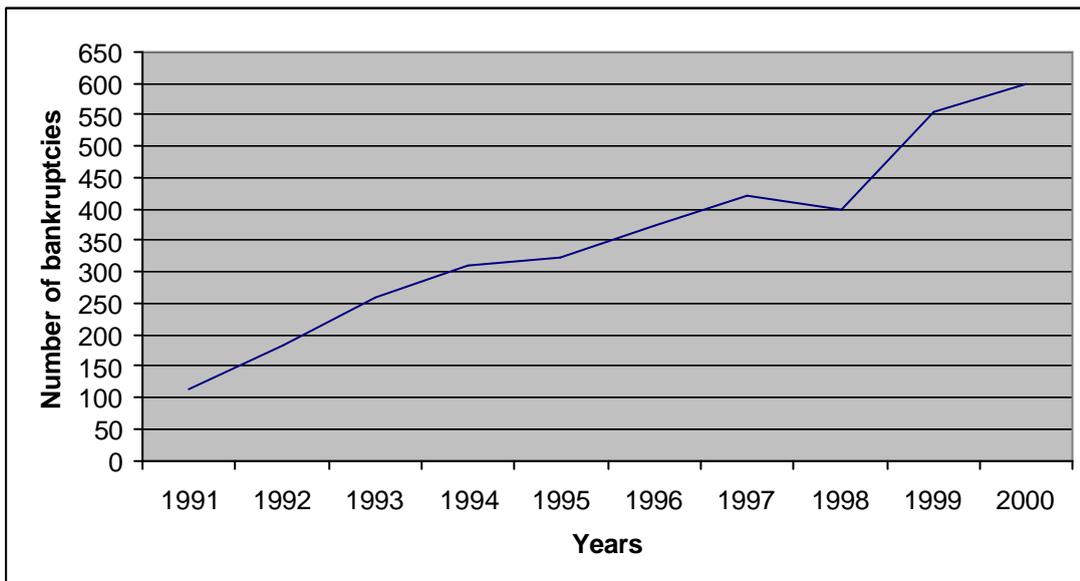
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TITLE 1. INTRODUCTION

Chapter 1.1. Summary of the historical and political lines of force of the insolvency legislation

Every year, the number of companies declared bankrupt increases. The number of bankruptcies declared in 1998 amounted to 399. In 2000, it reached 600¹. They were more than 700 in 2001 and already 55 have been declared for the month of January 2002². This is not as serious as it seems to be because a link exists between the number of new companies, which regularly increases and the number of bankruptcies. The number of incorporated companies amounted to 1.000 in 1980 and 6.600 in 2000³. However, the increase in the number of bankruptcies has led to a reaction in the media, who are calling for more sanctions to be taken against managers. The media has reacted against the immunity that benefits some managers, who do not assume personal responsibility.

You will find below a chart representing the evolution of the number of bankruptcies in Luxembourg in the last ten years.



Chapter 1.2. An overview of the current insolvency legislation applicable to companies and to individuals

The main provisions governing corporate insolvency are contained in the Luxembourg Commercial Code (“Code de Commerce”) laid down in the law dated September 15, 1807.

There are also some specific regulations such as the Law dated April 14, 1886 relating to compositions in order to avoid bankruptcy and the Grand Ducal Decree dated May 24, 1935 with respect to the controlled management.

Reference will also be made throughout this report to the Law dated August 10, 1915, as amended, on trading companies (“the 1915 Law”). Thus, Article 203 applies to any company, which pursues activities, which are contrary to criminal law or which grossly contravene the provisions concerning commercial companies. The second paragraph of this text allows the tribunal to apply as it thinks fit the rules governing bankruptcy.

Concerning the financial sector the law dated April 5, 1993 for financial institutions and the law dated March 30, 1988 for collective investment funds draw up particular procedures for this sector.

Thus, articles 60 to 62 of the Law of April 5, 1993 allow the tribunal to freely determine the liquidation regime by declaring applicable the rules governing bankruptcy where it think fit.

Similarly, with regard to common investment funds (*‘organismes de placement collectif’*), and to insurance, article 80 of the Law of March 30, 1988, and articles 55 to 57 of the Law of December 6, 1991 modified by the Law of December 8, 1994, respectively allow the tribunal to set up the liquidation procedure pursuant to the applicable rules it has chosen.

The Law of May 31, 1999 governing domiciliation of companies provides that the *Tribunal d’Arrondissement*’ seating in commercial matters may, upon request by the State Prosecutor, declare the closure of any premises situated in Luxembourg of a foreign company exercising activities, which are contrary to criminal law or, which grossly contravene the provisions of the Commercial Code or of laws governing commercial companies, including in relation to residence rights (article 203-1 of the Law of August 10, 1915).

The Luxembourg Civil Code draws a distinction between individual and legal entities, and between civil and business entities. This latter distinction is important because only business entities may be subject to insolvency and bankruptcy procedures as provided for in the Commercial Code. Obviously, civil entities may also come into a situation where they fail to meet their liabilities. This failure (“déconfiture”) will, however, not be acknowledged by a judgement, which has effects against third parties.

This report deals principally with those procedures that apply to cases of insolvency of corporate business entities.

TITLE 2. DEFINITIONS AND TERMINOLOGY

Chapter 2.1 Preliminary definitions

- « **Entrepreneurs** »: both individual traders and companies.
- « **Business entity** »: entity performing a business activity on a regular professional basis⁴ (Article 2 of the Commercial Code contains a non-exhaustive list of activities, which are deemed to be business activities but does not give any clear-cut definition of “business activity”).)
- « **Commerçants** » hereinafter «traders » individuals performing a business activity on a regular professional basis.
- « **Mémorial, Recueil des Sociétés et Associations** » hereinafter « Memorial »: official gazette of the Grand-Duchy of Luxembourg
- « **Registre de Commerce et des Sociétés** » hereinafter « Trade Register »: register kept at either the Luxembourg or the Diekirch District Court indicating all individuals engaged in trade or business and any commercial company or partnership.
- « **Registre des Hypothèques** » hereinafter « Mortgage Register »: register kept at the « Bureau des Hypothèques» hereinafter « Mortgage Registration office» including the assets charged, the capital sum secured and the name of the mortgages. Mortgages are required to be registered to establish their rank or relative rights of priority.

Chapter 2.2 Composition in order to avoid bankruptcy

« **Concordat préventif de faillite** » hereinafter « composition in order to avoid bankruptcy »: judiciary procedure introduced before the commercial court by an entrepreneur experiencing financial difficulties and wanting to avoid bankruptcy. An agreement is concluded between the entrepreneur and his creditors under the control and with the approval of the court. After ratification of the agreement by the court, the composition is binding on all unsecured creditors and on all creditors, who have waived their rights of priority or mortgages.

This should be distinguished from the «concordat après faillite » hereinafter « composition after the bankruptcy procedure », which is an arrangement between the entrepreneur and his creditors in order to avoid the legal liquidation of the assets of the entrepreneur.

Chapter 2.3 Reprieve from payment

- « **Sursis de paiement** » hereinafter « the reprieve from payment »: judiciary procedure introduced before the commercial court by an entrepreneur experiencing financial difficulties. An agreement concluded between the entrepreneur and his creditors has to be ratified by means of a court judgment. It allows the entrepreneur to suspend his payments for a limited period of time.
- « **Commissaire** » hereinafter « Commissioner »: person appointed by the Superior Court of

Justice among qualified persons, who are resident in the district of the residence or registered office of the entrepreneur to supervise and control the activities of the entrepreneur during the period of the reprieve from payment.

Chapter 2.4 Controlled management procedure

« **Gestion contrôlée** » hereinafter « controlled management procedure »: judicial procedure introduced by an entrepreneur, who has lost his creditworthiness and, who has difficulties in meeting his commitments, in order to reorganize his business or to convert his assets into cash under the supervision of the court and of commissioners appointed by the court with the approval of the creditors.

Chapter 2.5 Bankruptcy procedure

- « **Faillite** » hereinafter « bankruptcy »: judiciary procedure introduced before the commercial court by the company itself, by the court of its own motion or by a creditor, in order to proceed to the realization of the assets, in case the company has ceased its payments and is unable to meet its commitments, and when its credit is exhausted.
- « **Cessation des paiements** » hereinafter « cessation of payment » or “suspension of payments”: statement of the commercial court that a company is persistently unable to face its liabilities.
- « **Période suspecte** » hereinafter « suspect period »: period between the date of the cessation of payments and the date of the bankruptcy order.
- « **Aveu** » hereinafter « deposition »: declaration that the entrepreneur has to achieve at the commercial court within one month after he experiences a cessation of payments.
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- « **Juge-commissaire** » hereinafter « official receiver »: person appointed by the commercial court among its members to supervise the operations, the management and the liquidation of the bankruptcy.
- « **Curateur** » hereinafter « trustee »: person appointed by the commercial court to manage the bankrupt company in the place of the debtor, to draw up an inventory of the assets of the bankruptcy, to realize the assets and to distribute the funds to the creditors after the deduction of the trustee’s fees and the administration costs of the bankruptcy.
- « **Ministère des Classes Moyennes** »: public administration that is among others in charge of the deliverance of trading licenses.
- « **Masse** » hereinafter « mass »: goods and rights of the bankrupt person that constitute the estate to share between creditors. The mass is specially designed to pay them. A distinction must be operated between debts « of » the mass and debts « in » the mass:

TITLE 3. WARNING LIGHTS AND PREVENTION OF INSOLVENCY

According to Michel Former, managing advisor in the « Chambre de Commerce » of Luxembourg, « the legislation should be more orientated towards prevention by creating warning lights. The law in force only aims at liquidating bankruptcies as quickly as possible. »⁵

Chapter 3.1. Pre-Warning Lights Indicators: Protests and court orders compelling payment

Currently, the warning lights are represented by the protest list. The protest is the solemn declaration by a public notary on behalf of the holder of a bill of exchange (or any other instrument of payments), which notes that it has not been paid. It also declares the liability of all parties to the instrument for any loss or damage arising out of the dishonor. Legal interests run from the date of the declaration.

Protests are lodged with the clerk's office.

The existence of protests establishes that the company faces difficulties in paying its debts or is not willing to pay them (whether for a good reason or not).

Another interesting indicator of the precarious financial health of a company is court orders compelling the company to make payment of its debts. After many unanswered summonses, a creditor may indeed wish to take proceedings against his debtor.

Protests and court orders may be obtained either by directly addressing to the Clerk's office of the Commercial Court or through *Agence Avus S.àr.Ĺ.*, a company duly authorized by the clerk of Court to establish a listing of the current protests and court orders .

Apart from protests and courts orders, it has to be pointed out that until now, there is no advanced procedure or structure charged with the detection of entrepreneurs, who experience difficulties in order to help them to prevent insolvency.

Chapter 3.2. The role of the Trade Register

The prevention of insolvency could be organised at the level of the trade register, in particular with the deposit of the accounts of the companies but the current system and the legislation in force are not appropriate to organise this type of prevention for various reasons.

First of all, the trade register is not available online, which would ensure a certain transparency of the activities of companies registered in Luxembourg. It is difficult to be informed of the documents that have been deposited with the trade register.

Moreover, the legislation in force in Luxembourg is not adapted; commercial companies have to deposit their annual accounts with the trade register within one month of the annual general meeting that approves them. The latest is January 31, the year n+2. But due to a lack of manpower in the trade register, no strict control is carried out and therefore no penalty is applied.

Under the 1915 Law, managers and directors, who have not submitted to the general meeting within twelve months after the end of the financial year, the annual accounts, the consolidated accounts, the management report, the certificate of the person entrusted with the audit, as well as managers and directors who have failed to publish such documents are punishable by a fine of EUR 495,79 to EUR 24.789,5⁷. In practice, a company that neither deposits its accounts nor publishes them for eight years does not receive any penalty and does not suffer any consequences.

Moreover, sole traders are not under any obligation to either deposit such accounts or to draw up financial statements in a standardized form.

In that case, it is extremely difficult for the public prosecutor's department to take any measures for the prevention of insolvency.

However, several changes are planned; a project of law is currently under review regarding the reorganization of the trade register, the bookkeeping and the annual accounts of enterprises. With the coming into force of this future law and an increase in staff numbers of the public prosecutor's department, it may be possible to introduce, as is the case in France, a less formal procedure to prevent insolvency and to identify warning lights that could prevent entrepreneurs from reaching the reorganization procedure, (for example "mandat ad hoc", "chambre d'enquête").

TITLE 4. LEGAL POSSIBILITIES TO CONTINUE ECONOMIC ACTIVITIES

The entrepreneur that experiences financial difficulties that are due to external causes as opposed to major problems of management, has to react in due time in order to avoid being declared bankrupt.

Initially, the entrepreneur may try to negotiate with his creditors, so as to obtain an extension of the terms of payment or the remittance of his debts by concluding agreements with them. These agreements are subject to the normal rules applicable to the law of contract and are only binding on the parties to the agreement. As a consequence, these agreements may only succeed to the extent that all the creditors of a particular entrepreneur accept them.

Moreover, the Luxembourg legislator has established certain procedures with the intention of putting on binding form the agreements, which have been reached between entrepreneurs in difficulty and their creditors. These procedures are the following:

the reprieve from payment (« sursis de paiement »)⁸;

the composition in order to avoid bankruptcy (« concordat préventif de faillite »)⁹;

the controlled management (« gestion contrôlée »)¹⁰;

Moreover, a recently enacted regime, applicable only to credit institutions experiencing financial difficulties, has its origins in these procedures (the suspension of payments).

As the composition in order to avoid bankruptcy (« the composition ») has not been used for ten years, we will not describe it in a separate part of the report. This procedure may be summarized as follows. The composition is governed by the law dated April 14, 1886 (« the 1886 Law »), which has been amended successively in 1911, 1934, and 1935.

A composition is defined as a judiciary procedure leading to an agreement between a company experiencing financial difficulties and its creditors. The agreement is made under the control and

with the approval of the court in order to avoid bankruptcy¹¹. The agreement may consist of the extension of the time for payment of the debts, the reimbursement of part of the claims by means of a lump sum payment, the partial reimbursement by instalments of the debts, and similar devices. The entrepreneur is the sole initiator of the procedure¹². After ratification by the court, the composition is binding on all unsecured creditors and on all creditors, who have waived their rights of priority or mortgages.

Seldom used, it would in our opinion be better to remove this procedure and develop the procedure of controlled management.

Chapter 4.1 The reprieve from payment («sursis de paiement»)

§ 1. Description of the regime and its underlying philosophy

1.1. Description

This procedure was established by a Grand Ducal decree dated October 4, 1934 and was inserted in the Luxembourg Commercial Code under Articles 593 to 614.

The purpose of the reprieve from payment is to allow a business experiencing financial difficulties to suspend its payments for a limited period of time. The reprieve from payment acknowledges and ratifies, by means of a court judgment, an agreement, which has been stipulated with the creditors.

During the period of time the reprieve from payment is in force, the entrepreneur loses the right to manage solely his assets and is only allowed to manage his business under the control of « commissaires » hereinafter « commissioners »¹³.

1.2 Critical analysis

The objective of the procedure appears to be positive, however, there are only between six and eight cases per year.

§ 2. Overview of the procedure

2.1. Description

In order to get a reprieve from payments and to fix new terms of payment for a certain amount of time, the entrepreneur files an application simultaneously with:
the commercial court of the district, where the entrepreneur is registered; and
the Supreme Court of Justice¹⁴.

The commercial court may appoint experts in order to verify the existing situation of the debtor's business and may also appoint a judge to supervise this verification process. From the date of the filing of the application, or in the course of its investigation, the court may grant to the debtor a provisional reprieve from payment.¹⁵

Within two weeks of the receipt of the request of the entrepreneur, the president of the commercial court convenes a creditors' meeting¹⁶. Creditors or their representatives and the entrepreneur are heard during the meeting. The creditors declare the amount of their claims and

indicate if they give their approval on the reprieve from payment. They may do so in writing. A procès-verbal is drawn up.¹⁷

Following this, the commercial court issues an opinion, which is forwarded within three days to the public prosecutor (the « Procureur Général ») at the Superior Court of Justice. The latter submits this opinion with his comments to the President of the Superior Court of Justice, who appoints an adviser in charge of drafting a report, on which the Superior Court will base its decision within eight days of the receipt of the documents¹⁸. The procedure is thereafter based on the legal requirements relating to the convening of a creditors' meeting within a certain period, followed by the exchange of reports and opinions between the commercial court, the public prosecutor and the Superior Court. The latter renders its decision within eight days of the receipt of the documents.

Creditors are required to attend the meeting. They have to approve the proposals at a majority representing three quarters of all the outstanding amounts, before these proposals can take effect. For the purpose of calculating the required majority, those claims that are secured by rights of priority, mortgages or pledges, as well as the tax claims and other public charges are not taken into consideration¹⁹.

2.2. Critical analysis

This procedure requires the intervention of so many different actors that it renders it arduous and time consuming. The key factors for the efficiency of such a procedure are their flexibility and their rapidity.

The provisional reprieve from payment that may be granted to the debtor is significant and of interest as it protects the debtor against his creditors.

§ 3. *Criteria to benefit from the regime*

3.1. Description

The reprieve from payment may only be granted in the following cases²⁰:

- the entrepreneur forced by extraordinary and unforeseeable events to cease his payments temporarily and who has sufficient assets and funds according to its duly verified balance sheet in order to satisfy all creditors, in principal and interest; or
- the situation of the entrepreneur²¹, although currently in deficit, shows strong potential, which could allow a restoration of the financial situation.

3.2. Critical analysis

As these criteria are subjective, it is difficult for the entrepreneur to have the necessary insurance for the court to accept its request. This may deter him from launching the procedure.

§ 4. *Initiators of the procedure*

4.1 Description

The sole initiator of the procedure is the entrepreneur²², who must request a respite from payments to the commercial court and the Superior Court of Justice and provides them with the following documents:

- a description of the events, on which he bases his request;
- an inventory of his assets and liabilities;
- a list of creditors.

4.2. Critical analysis

On the one hand, it is understandable that the entrepreneur is the sole initiator of the procedure because the system that will be put into place is built around him. On the other hand, the entrepreneur often waits too long much time before asking for a reprieve from payment and in the meantime, his commercial situation deteriorates.

Lastly, the entrepreneur may not have sufficient knowledge of the procedures in place that he can benefit from. In these circumstances the benefits of a commission of prevention, who could provide information on this procedure to entrepreneurs in difficulty in due time in order to prevent them from insolvency.

§ 5. Administration of the procedure

5.1 Description

If the Supreme Court of Justice grants the entrepreneur a reprieve from payment, the Superior Court designates one or more commissioners, who will be in charge of the supervision and the control of the activities of the entrepreneur during the period of the reprieve from payment.²³

The commissioners will be chosen among the qualified persons domiciled in the district of the domicile or the registered office of the entrepreneur²⁴.

During the reprieve, the debtor may not sell or grant security over any of its movable property or real estate, nor may it plead, compromise, take loans, receive funds, make payments or perform any management activity, without the authorization of the commissioners²⁵. This authorization is not subject to any specific formality.

The supervising commissioners will, however, only have overall control of the business as opposed to the power of active management. This control rests in granting or in refusing the debtor the authorization to enter into transactions. If the commissioners refuse the authorization, and the debtor persists, the final decision will have to be taken by the commercial court²⁶.

5.2 Critical analysis

The law does not specify, who is entitled to be a commissioner. Generally, the persons chosen are lawyers assisted by experts, who are chartered accountants. In many cases, these lawyers have limited time to perform their functions in the best manner and are generally unsatisfied with the fees they are granted.

§ 6. The reprieve of payment

6.1. Description

While the commercial court does all the preliminary work and may grant a provisional reprieve, the Supreme Court of Justice is the sole competent court to grant the order for reprieve from payment, after having checked that the requisite majority of creditors has been obtained.

6.2. Critical analysis

The requirement of a majority of the creditors representing three quarters of the amounts due to the creditors accepting the proposal of reprieve of payments may be one of the reasons, which renders this procedure unattractive and difficult. It would be better if the law required a lower percentage of creditors, so that more reprieves of payment would be granted.

§ 7. The degree of protection of the actors implied in the procedure

7.1 Description

The protection of creditors appears to be well ensured. Convening notices are sent by registered mail and published in relevant newspapers. Moreover, the text of the articles describing the procedure for the reprieve from payment²⁷ has to be included in the convening notices in order to inform the creditors²⁸.

Two categories of creditors have to be distinguished:

- The creditors, who have some claims secured by rights of priority, mortgages or pledges; and
- The creditors, who have some unsecured claims.

Creditors, who have claims secured by rights of priority, mortgages or pledges do not intervene in the reprieve from payment procedure²⁹. Even if the reprieve from payment is granted, it will not affect them and they may act against the entrepreneur for payment of their claims. Secured creditors may also seize and sell secured assets of the company or business for their benefit. However, creditors having claims secured by mortgage or pledge may not, for the period of the reprieve, seize or sell real estate and other property needed for the performance of the profession or the business of the debtor, provided that accruing interest on the secured claims is paid in accordance with the terms of the loan³⁰.

Creditors having unsecured claims are in principle bound by the reprieve of payment, but there is one exception: creditors having unsecured claims arising from contracts concluded after the date on which the reprieve from payment was granted are not bound by the reprieve³¹. They may require the payment in full of their claims even to the extent of enforcing a judgement rendered against the entrepreneur.

7.2. Critical analysis

It would have been more secure for the entrepreneur if the secured creditors were also bound by the court decision on the reprieve from payment.

The different treatment of the creditors may be explained by the fact that the legislator attempting to balance the interests of the entrepreneur on one hand and the interests of the creditors on the other.

§ 8. Termination of the procedures

8.1 Description

The Court decides upon the duration of the reprieve³² and upon the extension that may be granted at the request of the entrepreneur if he files an application with the Supreme Court of Justice. If the latter rejects such an application, this automatically means a revocation of the reprieve³³.

On the side of the debtor, he may decide to withdraw his application for a reprieve even prior to the court decision granting him the reprieve from payment³⁴.

The revocation of a reprieve may be requested by one or more creditors or by the commissioners if it appears that the beneficiary of the reprieve has committed a fraud, acted in bad faith, violated the rules regulating his incapacity, or if it appears that the entrepreneur refuses to dispose of sufficient assets to repay all its debts in full. A request for revocation has to be filed with the commercial court, which will, after having heard the arguments of the entrepreneur, either take a decision where the reprieve had been granted provisionally, or issue an opinion where the reprieve was final. In the latter case, the commercial court will defer to the Superior Court of Justice, which will have to render a final decision³⁵. Once a reprieve from payment has been revoked, the creditors' ability to enforce their claims against the entrepreneur is restored.

8.3. Critical analysis

For financial institutions, the law indicates that the period of the suspensions of payments may not exceed six months³⁶. It would be necessary to insert this rule in the Commercial code for the commercial companies.

§ 9. Information on the procedure towards creditors

9.1. Description

As mentioned in §7 and §12 of this chapter, the creditors are well informed as a result of the requirement of publicity of their convening notices and of the judgements of the courts.

At the meeting of the creditors, the report of the official receiver is read to them before they vote on it. The decision is published and stuck up³⁷.

During the period of reprieve of payments, the creditors can at anytime ask the commissioners for information on the current status of the procedure.

9.2. Critical analysis

The procedure can be described as very transparent. However, in certain circumstances it may be better for the reputation of the entrepreneur in difficulty to benefit from a more confidential procedure.

§ 10. *Costs related to the procedure*

10.1. Description

Various costs will have to be supported by the entrepreneur:

- If the case may be, the lawyers' fees;
- The procedural costs. The entrepreneur has to deposit the sum presumed to be necessary to cover the costs for the convening of the creditors and for the insertions made by the clerk of the court³⁸;
- The commissioner's fees that are determined by the court depending on the nature and the importance of the debtor's activity³⁹.

10.2. Critical analysis

This procedure put in place for the entrepreneurs experiencing financial difficulties is expensive, which is incoherent. It deters in particular small companies from applying for the reprieve from payment.

§ 11. *Competence, knowledge and functioning of insolvency (bankruptcy) courts*

11.1 Description

The judges of the commercial court and of the Supreme Court of Justice need to have knowledge in the legal field, but also clear competencies in accountancy and a good understanding of the economic situation of the debtor.

11.2 Critical analysis

The judges in charge of these files are aware of the economic and accountancy fields, some of them are more dedicated to the financial sector.

§ 12. *Publicity conditions*

12.1. Description

The creditors are convened by the official receiver by registered mail eight days before the date of the meeting and the convening notices are published in certain newspapers.

The convening of the creditors as well as the judgement are published in newspapers designated by the judge. The judgement is also stuck up in the Commercial Court.

12.2 Critical analysis

As the procedure is public, it has the consequence that both clients and banks are directly distrustful of the debtor.

Chapter 4.2. The controlled management (« gestion contrôlée »)

§ 1. Description of the regime and its underlying philosophy

1.1. Description

Controlled management (« gestion contrôlée ») is governed by the Grand Ducal Decree dated May 24, 1935 (« the 1935 Decree »).

Controlled management is a remedy granted by the court to protect a company, which has lost its creditworthiness or which has difficulties in meeting all of its commitments. Controlled management should help such a company either to reorganize its business or to convert its assets into cash under the supervision of the court and of commissioners appointed by the court with the approval of the creditors.

1.1. Critical analysis

The controlled management procedure is the most common reorganization procedure.

The procedures of the reprieve from payment and of the composition in order to avoid bankruptcy are not suitable for the purpose of obtaining the reorganization of an entrepreneur in financial difficulties. Indeed, practice has shown that they are complicated and have the major defect of having no effect on secured and privileged creditors.

Moreover, to liquidate its assets under the circumstances of the controlled management, the procedure is likely to be more satisfactory from the point of view of the entrepreneur and his creditors than if the liquidation was forced upon the company by a terminal bankruptcy.

§ 2. Overview of the procedure

2.1. Description

The applicant must file a formal application with the commercial court of the district of his principal establishment or registered office in case of a company. This application must set out the following indications:

- the difficulties justifying a controlled management decision;
- the detailed description of the assets of the company;
- the nominative list of all the creditors⁴⁰.

At this stage, the procedure is not public. The court will fix a date for a preliminary hearing where the applicant presents the arguments in favor of a decision for controlled management⁴¹.

Three scenarios may happen:

- The court is not convinced that the controlled management procedure is adapted to the situation: the court rejects the application⁴²;
- The court finds that the applicant has already ceased the payment of debts: it can

immediately open the bankruptcy procedure;

- The court accepts the application: it will designate one of the judges of the commercial court as responsible for the preparation of a report on the financial situation of the business of the entrepreneur⁴³. An expert may assist the judge⁴⁴. In practice, he is often a chartered accountant.

In this case, the creditors can still sue the entrepreneur but they are no longer allowed to enforce any court decisions against him⁴⁵.

When the report of the judge has been filed, the court plans a second hearing for the pleadings and decides whether the controlled management should continue⁴⁶. At this stage the court may adopt two types of decisions:

- to dismiss the application for a controlled management order. In this case, it may open the bankruptcy procedure if the conditions for a bankruptcy order are met⁴⁷; or
- to place the assets of the applicant under the control of one or more commissioners.⁴⁸

In the second case, the duties of the commissioners may be summarized as follows:

- to draw up an inventory of all the assets, which are under controlled management, and to draw up an inventory of all the assets and the liabilities of the entrepreneur and to draw up the balance⁴⁹;
- to intend some actions in the place of the debtor⁵⁰;
- to prepare a plan for the reorganization of the business or for the realization of the assets of the entrepreneur and the distribution of the proceeds⁵¹;
- to supervise the company, which has been placed under controlled management, and to give the authorization that is necessary for those acts, which the company is no longer free to perform due to the controlled management⁵².

The commissioners have to communicate the plan that they have prepared to all the creditors secured or unsecured, to the co-debtors, who are jointly and severally liable with the applicant and to the guarantors known by the commissioners⁵³. The creditors will either accept or reject the plan.

Within fifteen days of the date of the communication and publication of the plan, the creditors must inform the court whether they accept or refuse the proposals made by the commissioners. There is no requirement in this procedure for creditors to attend a meeting. They vote in writing and may address any written comments to the court.⁵⁴

Following this the court convenes the entrepreneur in order to take a decision with respect to the plan. It may only approve the commissioners' plan if it has been accepted by a majority of more than fifty percent of the creditors representing, by reference to their unchallenged claims, more than half of the liabilities of the business entity. Any creditor, who abstains from voting is deemed to have accepted the plan.

The court benefits from a discretion to reject a commissioner's plan approved by the creditors and checks if the legal provisions have been complied with, if the proposals made by the commissioners take into account the ranking of the existing rights of priority, and if there is any other reason, which could stand in the way of the approval of the plan.

If the court considers it impossible to approve the commissioners' plan, the application for controlled management is dismissed or the court may decide to order the commissioners to prepare a new plan within a specified time⁵⁵. After having convened the entrepreneur, the court will approve or reject (with discretionary power) the commissioner's plan.

The functions of the commissioner's cease upon approval by the court of the plan submitted to the creditors.

2.2 Critical analysis

The controlled management procedure is the most commonly used procedure and for about 45% of the cases, it could save the company and avoid its bankruptcy.

However a "modernisation" of this procedure would be welcome. A pilot study and a pre-project of law is at the moment in preparation.

It appears from statistics that controlled management proceedings are rarely successful and often end up in bankruptcy. The procedure is indeed very complex and entails a large number of procedural actions.

§ 3. Criteria to benefit from the regime

3.1. Description

The benefit of the controlled management procedure is available either to entrepreneurs, who have either lost their creditworthiness or are having difficulties meeting all their commitments⁵⁶. Controlled management is not available, however, if the applicant has already been declared bankrupt by final judgment⁵⁷. Loss of creditworthiness may be established by the fact that no creditor or other related party is willing to grant any further credit to the debtor, whether in form of a loan, guarantee or in the rescheduling of debts.

Even if the law does not require as a condition the debtor to act in good faith, the courts take it into account and refuse the benefit of the regime to applicants who appear to have committed fraud or gross mistakes or irregularities in the management of the business.

The application for a controlled management order must either envisage a re-organization of the business or a better realization of the assets of the applicant. An order of controlled management will be granted if it appears that the applicant only wishes to reschedule or cancel part of the existing debts.

3.2. Critical analysis

The procedure could be improved if the criteria required to benefit from the controlled management procedure were wider, allowing the procedure to be available to the entrepreneur at an earlier stage, for example as soon as a threat of cessation of payment (« cessation des paiements »)⁵⁸ appears, without excluding the hypothesis of the entrepreneurs, for whom the cessation of payment is already established. Some flexibility would be welcome at that stage of the procedure, where improvement of the debtor's situation is still possible.

§ 4. Initiators of the procedure

4.1. Description

The sole initiator of the procedure is the entrepreneur⁵⁹.

4.2. Critical analysis

We can formulate the same critic here as was done for the reprieve from payment; it could be beneficial if a public commission in charge of the detection of entrepreneurs in financial difficulty could inform such entrepreneurs of the possibility of initiating the controlled management procedure.

It has also to be pointed out that neither the statutory auditor nor the auditor (« réviseur d'entreprises »), who are well informed, is entitled to initiate the procedure.

§ 5. *Administration of the procedure*

5.1. Description

During the preliminary procedure and up until the date the entrepreneur is placed under controlled management, the judge, who has been designated by the court to make a report on its financial situation supervises his activities⁶⁰.

The entrepreneur retains the power to manage his assets but is no longer allowed to act without the authorization of the commissioners⁶¹. Should the entrepreneur act without authorization, the acts will be null and void. The judge will only give his authorization if the act does not cause any harm to the interests of the creditors and does not have an adverse effect on the pursuit of the controlled management procedure.

5.2. Critical analysis

The procedure could be improved by providing more flexibility and suppressing the systematical appointment of a delegated judge or a commissioner to supervise the entrepreneur⁶². Moreover, the requirement that authorization be given by the judge or the commissioner for each act that the entrepreneur performs could be reserved for only the most important operations, (i.e. the acts that do not deal with the daily management of the company), with the exception of those cases where the court estimates that a more restrictive regime should be imposed on the company.

This measure could be beneficial for the following reasons:

- A practical reason: the current regime is so arduous that it is difficult to respect the rule;
- Several theoretical reasons: if the entrepreneur has chosen to follow the procedure, he should not be further penalised. Moreover, it would be better to let the entrepreneur manage his company for the continuity of the business in order to avoid alarming third parties with the intervention of someone that they do not know.

§ 6. *Restructuring plan*

6.1. Description

The plan established by the commissioners does generally not provide for the equal payment of all creditors. Different proportions are paid at different times to creditors, taking into account the nature and the size of their debts.

Once it has been approved by the court, the plan becomes compulsory for the business entity, for all its creditors (even for those who abstained from voting or who voted against) and for all the co-debtors and guarantors.⁶³

The court decisions rendered in this controlled management procedure are immediately enforceable, except when the application is dismissed. The applicant, or any of the creditors may, within eight days of the order, appeal against the decision dismissing the application for a controlled management order⁶⁴.

The court cannot interfere in the execution of the plan, which has been approved, nor supervise its execution. Finally, after the court has approved the commissioners' plan, the latter are relieved of their functions.

6.2. Critical analysis

The equal treatment of creditors is not respected because of the subjective pondering of credits.

§7. The degree of protection of the actors implied in the procedure

7.1. Description

The commissioners can be held liable in cases of negligent appreciation or verification of the state of business of the entrepreneur requiring controlled management or if he proves fault in drawing the inventory of the goods depending of the controlled management as well as the state of the active and passive situation of the entrepreneur. This ensures some form of respect of the creditors' situation.

7.2. Critical analysis

In practice, it is not so easy for the commissioners to act both in the interest of the entrepreneur and in the interests of the creditors. The objective is the protection of the company, but the decisions taken do not have the same impact where the controlled management is terminated by bankruptcy or by a new solvent start.

§8. Termination of the procedures

8.1. Description

If the company defaults on the commissioner's plan, it may be opposed by any creditor (whether he has voted in favour of the plan or not) by starting court proceedings against the debtor in order to obtain the cancellation of the plan.

If the company does not then perform its obligations, any creditor may institute court proceedings for the cancellation of the plan. If unsuccessful, the court may terminate the plan and declare the company bankrupt.

8.2. Critical analysis

From our point of view, the controlled management procedure should be as brief as possible. A maximum duration should be included in the law. A maximum duration of six months is common to Belgian and French law.

§9. Information on the development of the procedure towards creditors

9.1. Description

As explained above, creditors cannot initiate the procedure and are not involved in the preliminary procedure. They may, however, appeal against the court decision, which has placed the debtor under controlled management⁶⁵.

The creditors are only consulted at the stage of the proposal of the reorganization plan, which is after the start of the controlled management of the company⁶⁶.

9.3. Critical analysis

The creditors are presented with a « fait accompli ». However, it is understandable that confidentiality is preserved in order to reorganize the activity of the entrepreneur.

Furthermore the right of appeal against the court decision is often only a theoretical right as the appeal has to be filed within a relatively short period and the judgement placing the debtor under controlled management is not published. As a result, the creditors may well only be informed of the court's decision after the expiration of the time for the appeal.

§ 10. Costs related to the procedure

10.1. Description

Taking into consideration the complexity of the file, the court determines the fees and expenses of the commissioners and of the expert, according to the difficulties of their tasks. They have to be paid by the entrepreneur by privilege⁶⁷.

10.2. Critical analysis

For large companies that have had major problems with management, the procedure is expensive and not adequately remunerative for the commissioner according to his normal hourly rate chargeable to clients.

§ 11. Competence, knowledge and functioning of courts

11.1. Description

As mentioned above, it is the commercial court, where the entrepreneur or the company has its registered office that is competent.

The court should appoint a judge to prepare a report on the situation of the entrepreneur occasionally with the assistance of an expert. After that the court holds a public hearing of its

decision whether or not to open the controlled management procedure. Following the opening of the procedure, the reorganization plan is also submitted to the court, which will hear the different parties convened in a public hearing.

11.2. Critical analysis

The procedure can be described as overly complicated and drawn out.

§ 12. *Publicity conditions*

12.1 Description

No publicity is made before the appointment of a commissioner. The announcement of the fact that a company is being put into controlled management is made in the Memorial⁶⁸.

The judgement approving the plan of the commissioner is published in the Memorial and in one national newspaper.⁶⁹

12.2 Critical analysis

From the perspective of the preparation of the plan, the procedure would be improved if anyone could have information on the company, so that potential trade-in proposals could be submitted. Moreover, the creditors would always wish for the increased transparency of the procedure. However, we are of the opinion that the procedure benefits from sufficient transparency and as with the reprieve from payment, it does not preserve the necessary confidentiality.

Chapter 4.3 The suspension of payment (“sursis de paiement”) and supervised administration (gestion contrôlée) for financial sector institutions (banks)

The law dated April 5, 1993, on the financial sector, as amended, organizes the suspension of payments and controlled management for credit institutions. As this law is similar to the regulations applicable to commercial companies, we will not detail this procedure further.

However, some particularities should be mentioned, in particular with regard to the Regulatory Commission (“Commission de Surveillance du Secteur Financier”, hereinafter “CSSF”).

The CSSF may initiate the procedure⁷⁰. Where the Commission is the initiator, it is required to deliver the petition to or serve it on the institution concerned by registered letter or by bailiff’s notice (“*signification par exploit d’huissier*”)⁷¹.

If the credit institution initiates the procedure, it must, before referring the matter to the Court, notify the Commission and, except in urgent cases, enclose the Commission’s comments with the petition⁷²;

The Commission shall automatically perform the function of commissioner until a decision is taken on the petition⁷³.

Several special rules have been introduced by the law dated August 1st, 2001 with respect to the transfer of property for collateral mentioning that payments made to a financial institution on the day of the lodging of a petition at the office of the clerk of the Court shall be legally enforceable and binding upon third parties, the institution itself and the commissioner⁷⁴.

The above-mentioned law introduced the same rule with respect to the set-off or netting of mutual claims and obligations shall be legally enforceable and binding upon third parties, provided that it

is applied to transactions, which are the subject of a bilateral or multilateral netting agreement or clause between two or more parties. Linkage, termination, revocation, joint liability, margin call and accelerated repayment clauses, determination and set-off procedural provisions, together with any other contractual stipulations governing the netting process, shall also be legally enforceable and binding upon third parties, supervisory auditors, trustees in bankruptcy and liquidators or any similar officers, and shall remain effective despite the commencement of the financial assistance or re-organization procedure, irrespective of the timing of the conclusion or execution of such clauses, provisions or stipulations.⁷⁵

In the procedure of the reprieve from payment, one or more commissioners are systematically appointed⁷⁶. Unlike the controlled management procedure, the court may limit the scope of the operations submitted to the authorization of the commissioners⁷⁷.

The requirement with respect to the publication of the judgment approving the reprieve from payment and appointing the commissioners is more important; it has to be published in the Memorial and in at least three Luxembourg and foreign newspapers designated by the court⁷⁸.

TITLE 5. LEGAL CONSEQUENCES OF BANKRUPTCY AND POSSIBILITIES FOR A FRESH START

The bankruptcy procedure (or « faillite »)⁷⁹ is governed by provisions, which were introduced into the Luxembourg Commercial Code (art 437-592) by the law dated July 2, 1870.

The purpose of the bankruptcy procedure is to realize the assets of the debtor and to distribute the proceeds to the creditors. However, a company, which has been adjudicated bankrupt does not inevitably disappear as a result of the bankruptcy. The bankruptcy does not, indeed, necessarily entail the winding-up of the company.

Chapter 5.1. Bankruptcy procedure

§1. Criteria to declare a company and individuals bankrupt

A Company is bankrupt when, having a commercial object, it has ceased its payments and is unable to meet its commitments, and when its credit is exhausted⁸⁰. The two conditions are cumulative.

1.1. Suspension of payments

First of all, the company must have suspended payment of its debts.

Suspension of payments is the material status of the trader, who can no longer pay his liquid and due debts. It is not necessary that he has suspended all payments, as long as the main ones have been suspended. A momentary state of suspension of payments is insufficient. Insolvency (debts amounting to a higher amount than assets) is insufficient. Credit may still enable the company to survive.

This might be established in various ways, for example:

- The company has accumulated numerous debts;
- A judgement ordering the company to pay a given amount of money cannot be enforced;
- The company's property is seized;
- The registered office is closed.

1.2 Exhaustion of commercial credits

The credit of the company has to be exhausted. The credit of a company is considered exhausted if the suspension of payments is such that the state of the debtor's business does not inspire any trust.

The two above-mentioned provisions must be met at the date of the bankruptcy order.

1.3 Delays

A person, who no longer exercises a commercial activity, can still be declared bankrupt if the cessation of payments happened at a time when he was a trader⁸¹.

The entrepreneur in his personal name may only be declared bankrupt where he had the position of trader during the six months that preceded the bankruptcy. The entrepreneur, who remained registered at the Trade Register, is presumed to have kept his position of trader. The burden to prove that he did not have this position during the six months preceding the bankruptcy lies on him. On the other hand, the trader, who was no longer registered during the six preceding months can no longer be declared in a state of cessation of payments, unless otherwise proved.

The commercial court determines a period for the cessation of payments⁸².

The time of cessation of payments cannot be established at a date more than six months prior to the judgement declaring the bankruptcy, except in one case⁸³. In case of bankruptcy of a debtor not exceeding six months after the expiration of the reprieve, the time of the cessation of payments will be determined at the day of the request for a reprieve for payment⁸⁴.

If the court does not determine this date, six months must be counted as from the date of the judgement declaring bankruptcy.

A commercial company can be declared bankrupt so long as its liquidation is not closed.

In conformity with Article 157 of the Law on commercial companies, all actions against liquidators prescribe after five years from the date of publication set by Article 151 of the law. Therefore, even though the company's liquidation is ended and can no longer be declared bankrupt, third parties still have an action against the liquidators, associated with the company until the end of the five-year prescription.

A bankrupt company is only subject to the legal provisions of bankruptcy when it has been adjudicated bankrupt by the court.

Declaration of bankruptcy is subject to a number of legal requirements in terms of delays.

§2. Competent court

The competent court for declaring bankruptcy is the commercial court of the domicile of the bankrupt person or the registered office of the bankrupt company at the time of the cessation of payments⁸⁵.

Article 502 paragraph 2 provides that the « juge-commissaire » shall refer to the commercial court any dispute relating to non-admitted claims. However, where such disputes are not part of the commercial court's competence, they shall be referred to the competent judge for the substance; the commercial court decides in conformity with Article 504 to what extent the litigious creditor shall be entitled to participate in the deliberations regarding the composition. Most frequently encountered problems relate to salary claims.

§3. Actors of the procedure

3.1. The « juge-commissaire » hereinafter « official receiver »

Through the declaration of bankruptcy, the commercial court appoints an official receiver, from among the judges of the district court seated in commercial matters. He officially closes the

enterprise and officially marks the accessible places where the buildings can be entered (procedure of appealing of seals, « apposition des scellés »)⁸⁶.

The official receiver is required accelerate the bankruptcy proceedings and to supervise the operations, the management and the liquidation of the bankruptcy. To the extent that a decision has to be taken by the commercial court in connection with the bankruptcy procedure because of some objections, the appointed judge must transmit a report to the commercial court. The official receiver has to decide on those urgent measures necessary for the conservation and the guarantee of the mass of assets. He is the chairman of meetings organized by the creditors of the bankrupt⁸⁷.

3.2 The « curateurs » hereinafter « the trustees »

With the judgement declaring the bankruptcy, the commercial court appoints one or more trustees, the exact number depending on the importance of the bankruptcy⁸⁸. They are chosen from among the sworn liquidators instituted by the government⁸⁹ or from among persons presenting the most guarantees of the intelligence and fidelity of their management⁹⁰.

In practice they are chosen by the commercial court from the list of lawyers registered at the District Court of Luxembourg or Diekirch. The court may choose sworn persons such as expert accountants, auditors (« réviseurs d'entreprise »), in case there is an interest of the bankruptcy.

They carry out the administration of the company under the supervision of a judge appointed by the court and draw up the inventory of the assets of the company⁹¹.

The trustees have to defend the interests both of the creditors and of the bankrupt company. The trustees represent the company in any procedure and in any relationship with third parties. They also represent the creditors insofar as they act for their benefit.

3.3 The public prosecutor (« procureur d'état »)

The public prosecutor has the right to be present at all the operations of a bankruptcy. Furthermore, he can inspect all the commercial documents and the accounts of the bankrupt. He can verify the situation and obtain from the trustees all information he judges necessary⁹². In this way, he can obtain a comprehensive view of the situation of the company. He can decide on a public course of action against the bankrupt.

3.4 The creditors

The judgement of the commercial court declaring bankruptcy requires the creditors to file their claims with the clerk office of the commercial court and prove their claims within a period not exceeding twenty days from the date of the judgement.⁹³

The creditors may question the trustees as to the rendering of their accounts and provide them with disputes, if this leads to a dispute, the commercial court will give judgement on the point⁹⁴.

There is a particular case for clauses suspending the transfer of property (« clause de réserve de propriété »). In cases of bankruptcy, the traditional solution was to deny the debtor the right to oppose these clauses to the mass of creditors.

However, the law dated March 31, 2000 entitled « Loi relative aux effets des clauses de réserve de propriété dans les contrats de vente et modifiant certaines dispositions du Code de Commerce » brought about some changes and has modified Article 567 of the Commercial Code and

introduced a new article 567-1. This latter article provides that the principle of opposability of such clauses in case of the buyer's bankruptcy or composition in order to avoid bankruptcy is subject to certain conditions. The new law states that these clauses are opposable to the mass of creditors in case of bankruptcy under the following provisions:

- The collective procedure is a bankruptcy or a composition after bankruptcy (but not in case of controlled management);
- The assets are movable and fungible assets;
- The clause has been drawn up in written form and has been accepted at the latest at the moment of delivery of goods;
- The goods still exist in kind in the debtor's part;
- The action in recovery is exercised in a determined period (three months from the publication of opening of the bankruptcy proceedings).

§4. *Formal procedure*

4.1. The initiation of the procedure

The bankruptcy of a company is declared by the commercial court at the initiative of three types of entities⁹⁵: one or more creditors ("l'assignation"), the court of its own motion ("faillite d'office") or the company itself ("l'aveu").

Bankruptcy requested by a creditor: « l'assignation ».

Bankruptcy may be requested by one or more creditors⁹⁶. The creditor must summons the debtor before the commercial court and request its bankruptcy. The creditor has the burden to prove that the conditions for bankruptcy are fulfilled. The Court will often order solvency inquiries (« *enquêtes de solvabilité* ») before declaring bankruptcy upon summons.

The creditor who acted in bad faith can be held liable where the bankruptcy would not be declared.

As creditors frequently use this means of pressure on the company to get payment of their claims, the application filed with the commercial court does not automatically entail an adjudication in bankruptcy. Thus, if the debtor pays, the creditor will withdraw his application, but if the application has already come before the court, the court may declare the debtor bankrupt where they consider that there is sufficient evidence that the debtor is insolvent and has lost its creditworthiness.

Bankruptcy declared by the court of its own motion: « faillite d'office ».

This might be the case where the court, by virtue of its own personal knowledge gained in the course of actions brought against a company, considers that the company is bankrupt, or if an application for a controlled management order or for reprieve from payments has been dismissed on the basis of the documents, which were submitted to the court in support of the application.

Bankruptcy can only be declared by the court of its own motion after the debtor has been called by the clerk in the « *Chambre du Conseil* » to be heard on his situation. The bankruptcy may be

declared without calling the debtor, in cases of necessity which are specially justified by the elements in the judgement declaring bankruptcy⁹⁷.

In practice, bankruptcy is declared by the court of its own motion in the light of all the information communicated to the prosecution department, either by creditors or by the trustee wishing extension of the bankruptcy to another company close to that which is under his review.

This type of bankruptcy is controversial. As debtors argue that when they are not called, the rights of the defendant are not respected.

Bankruptcy declared by the company itself: « l'aveu ».

A trader or any commercial company that ceases payments must acknowledge this at the clerk's office of the commercial court of its domicile or registered office in the case of a company, within one month from the cessation of payments⁹⁸. Thus, any company, which is unable to meet its commitments and which is not given the benefit of a reprieve of payment proceedings nor controlled management, must acknowledge this and provide a statement enumerating and evaluating all the assets and the liabilities of the business entity and its accountancy records to the clerk's office⁹⁹.

In cases of such acknowledgement by a commercial company, a copy of the minutes of the Board of Directors agreeing on such admission must be provided for public companies limited by shares, a declaration signed by the managing director in limited liability companies, and in companies where partners have unlimited liability, the partners' agreement to file a petition in bankruptcy.

The non-respect of the procedure and delays for such acknowledgement may incur a criminal action for bankruptcy with irregularities deemed a breach of the law (« banqueroute simple »)¹⁰⁰. This is why, in practice, bankrupt's provide their acknowledgement more and more frequently.

Once the provisions for filing a petition for bankruptcy are fulfilled, an extraordinary general meeting does not need to be called to decide upon it: It is only the responsibility of the company's directors to declare it.

4.2. The judgement of the court

Members of the management team, who are personally liable for the debts of the bankruptcy, may bring an opposition against the judgement declaring bankruptcy.

If the company decides to admit its insolvency and loss of creditworthiness and thus its bankruptcy, it will, of course, explain its situation to the court.

If a petition for a bankruptcy order has been filed with the court and the court estimates that there is sufficient evidence with regard to the financial situation of the company, it may open the bankruptcy procedure within a very short time. If however, it appears that the court does not have sufficient evidence (for instance if the company does not appear on the list of the persons having protested bills of exchange), the court may decide to seek information on the solvency of the company from the financial division of the police.

If it appears from the report of the police that there is sufficient evidence that the conditions for bankruptcy have been fulfilled, the court will then immediately adjudicate the company bankrupt.

4.3. The consequences of a judgement declaring bankruptcy

In its judgement declaring the bankruptcy, the commercial court decides the following:

- The court appoints a judge to supervise the bankruptcy proceedings and appoints one or more trustees¹⁰¹.
- The bankruptcy judgement orders creditors to file and prove their claims within a period not exceeding twenty days from the date of the bankruptcy judgement. The judgement also fixes a closing date for the verification of claims and a date for a hearing at which the challenged claims will be examined by the court. The two dates must be between five and twenty days apart¹⁰².
- The court will determine a similar period between the time when the claims are recorded and the time, when the hearing dealing with the claims, which have been challenged, is to take place¹⁰³. This means that only the claims filed with the court clerk prior to the date on which the claims are recorded will be examined at the court hearing dealing with the challenged claims. Creditors may still file their claims at a later date. This does not have any adverse effect on the legal situation of the creditors, who have claims at a later stage of the procedure.

The trustees have to perform their assignment, which consists of the following tasks:

- Within three days of their appointment: publication of the bankruptcy judgement in newspapers specified by the court so that the creditors will be made aware that they have to declare their claims¹⁰⁴;
- Within three days of their appointment: requirement of the removal of the seals and writing of the inventory that has to be signed by the clerk and by the trustees and deposited with the court¹⁰⁵;
- Verification and rectification of a balance sheet as soon as the inventory of the bankruptcy has been completed and after the transfer by the bankrupt company of all accounting books and documents to the trustees¹⁰⁶;
- Sale of all the perishable assets or goods subject to an imminent depreciation¹⁰⁷;
- Collection of claims, that may be owed to the bankrupt company¹⁰⁸;
- Within fifteen days after their appointment: transmission of a memorandum on the appearing state of the bankruptcy, its principal origins, circumstances and characteristics to the official receiver¹⁰⁹. This receiver will immediately transmit the document with his observations to the state prosecutor¹¹⁰.

The bankruptcy judgement is immediately enforceable notwithstanding any right or recourse. Subject to legal requirements in terms of delays, any interested party, as well as the company declared bankrupt, may oppose/appeal against the judgement. Any interested party who has not been party to the lawsuit may oppose the judgement within fifteen days of its having been made. The company declared bankrupt has eight days to oppose, starting from the date when the bankruptcy judgement is published in the newspapers. The company could also appeal against a bankruptcy judgement before the fourteenth day of the notification of the judgement. As the means of recourse are quite uncertain, the bankrupt company normally chooses both ways (opposition and appeal) one is declared inadmissible but it permitted in all cases to have an

appeal.

The judgement terminates the duties of the trustees in bankruptcy and of the official receiver.

4.4 Closing of the bankruptcy procedure

The competent commercial court decides on the closing of the bankruptcy procedure.

The bankruptcy procedure can be closed in the following circumstances:

There might be a closure of the procedure because of an insufficient mass of assets to cover the administration and liquidation costs of the bankruptcy¹¹¹. In this case the creditors get back their right to sue the insolvent entrepreneur.

If it appears that the assets will be sufficient, a composition after the bankruptcy procedure may be set up¹¹². This procedure is exceptional in Luxembourg.

The third possibility would be the legal winding-up of the company¹¹³, where no arrangement is possible.

The trustees sell the immovable and movable goods and liquidate the liabilities under the supervision of the official receiver¹¹⁴.

At a hearing that the court has arranged once the fees and the costs have been fixed. The trustees must invite both the bankrupt company and all the creditors, whose claims have been accepted to attend the hearing and present their comments¹¹⁵. A notice outlining the plan for the distribution of the remaining funds must be attached to the invitation. The trustees must give evidence to the court that they have notified the creditors and the bankrupt company in respect of the hearing on the rendering of the accounts.

If the plan of the trustees plan is not questioned, the trustees, the appointed judge and the clerk of the court will sign it. The trustees may then pay the creditors in accordance with the plan after deduction of the trustees' fees and the administration costs of the bankruptcy.

Lastly, an application is filed with the commercial court for the termination of the bankruptcy proceedings once all the funds have been paid. In support of their application, they have to give evidence that they have made all payments they were bound to make. The court will declare the bankruptcy proceeded by ordering the winding-up of the company.

§5. Length of the entire procedure

The length of the entire procedure really depends on the nature of the bankruptcy. It has to be pointed out that about 45% of the bankruptcy proceedings are closed for insufficiency of assets, this kind of bankruptcy normally being closed within three to six months.

Chapter 5.2. Legal effects of the initiation of bankruptcy procedures

§1. Interests and fines stopping accruing¹¹⁶

From the date of the judgement declaring bankruptcy, interests on all claims that are not secured by a privilege, a pledge or a mortgage will stop accruing with regard to the mass only. The interests referred to are judiciary, legal or conventional.

However, if at the end of the bankruptcy, there is a surplus after all creditors have been paid in full, interests on any unsecured claim will be paid to creditors for the period between the bankruptcy order and payment of their claims.

Interests on secured claims may only be requested on sums coming from assets affected by a privilege, a pledge or a mortgage.

§.2 Actions against the bankrupt not allowed

After the bankruptcy order has been made, creditors have to present their claims. They are no longer allowed to take any individual action against the bankrupt company.

Any form of procedure, whether a personal action or procedures based on title to real property and all means of compulsory enforcement on movables or immovables may only be taken, or exercised, against the trustees¹¹⁷. The making of a bankruptcy order stops every seizure or attachment made at the request of secured creditors on movable or real estate. Bankruptcy removes third parties rights to take enforcement action against the bankrupt's assets. If a sale of seized movable assets or real estate through a public auction had been scheduled prior to the bankruptcy judgement, the sale will take place for the account and benefit of the bankruptcy.

Creditors may, notwithstanding bankruptcy, initiate procedures against co-debtors of a bankrupt person or company.

If the trustees sell real estate belonging to the bankrupt company, they are authorized to distribute the proceeds of the sale to those creditors with either mortgages or liens on this real estate. If the proceeds of the sale are not sufficient to reimburse secured creditors, these creditors will be treated as unsecured creditors for the balance of their claims.

Once all the assets in the bankruptcy have been converted into cash, the funds remaining after deduction of the costs and charges linked to the administration of the bankruptcy will be distributed first to secured creditors in order of priority. Any balance remaining will then be distributed to unsecured creditors in proportion to their claims.

§3. Suspension of the right of execution and of payment

At the time of the bankruptcy order, the court determines a date of the cessation of payments that is assumed to be the date, after which the debtor was unable to meet his commitments¹¹⁸. This date is in most cases assumed by the court to be six months and ten days before the making of the bankruptcy order.

The period between the cessation of payment and the date of the bankruptcy order is called « période suspecte » or « suspect period »¹¹⁹.

The commercial court shall determine, either by its own motion or under request of any interested person - interested creditors and the trustee - the time when the suspension of payments, either in the bankruptcy judgement or in an ulterior judgement, is set¹²⁰.

Two exceptions are admitted to the rule:

- Where the judgement declaring bankruptcy omits to indicate the date of suspension of payments, it is deemed to have happened as from the date of the declarative judgement or

as from the debtor's death if the bankruptcy was declared after his death¹²¹.

- Notwithstanding the application of Article 613, the period of suspension of payments cannot go back to a period more than six months prior to the judgement declaring the bankruptcy.

By way of derogation to Article 442 of the Commercial Code, the judgement declaring the trader's bankruptcy in the six months following either the judgement rejecting the request in controlled management, or the judgement approving the project of the commissioners (« commissaires ») can set the time of suspension of payments to six months prior to the date of deposit of the request¹²².

Certain transactions undertaken during this period **must** be declared null and void whereas some other **may** be declared null and void by the commercial court at the request of the trustee.

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

- disposition of the assets without consideration or for materially inadequate consideration;
- 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 other means than in cash or by bills of exchange; and
- mortgages or pledges granted to secure pre-existing debts¹²³.

The courts have decided that the cancellation of a sale and the restitution to the seller of the sold goods, which had been delivered may be declared null and void, unless the seller has obtained the cancellation on the basis of a provision contained in the sale agreement¹²⁴.

Set-off is permitted only if the reciprocal claims satisfy the conditions of independent set-off prior to the relevant insolvency date (*i.e.* they must be mutual), they are liquidated and they have matured. If the claims do not satisfy these requirements by the relevant date (*i.e.* prior to the suspect period), there can be no set-off and the creditor must pay the cross-claim into the insolvent estate for his primary claim.

Any other payments made by the debtor of debts, which had fallen due and any other transactions entered into during the suspect period may be declared null and void if the trustee can establish that the persons, who received payment from the debtor or the persons, who entered into a transaction with the debtor had known of the cessation of the debtor's payments¹²⁵.

Mortgages and rights of priority, which have been acquired on a regular basis, may be recorded on a register held by the Mortgage Registration office up to the point of the bankruptcy order. However, any registration made within the period between ten days prior to the date of the cessation of payments and the date of the bankruptcy order may be declared null and void if more than fifteen days have passed between the date of the deed granting the mortgage or the right of priority and the date of the registration¹²⁶.

Moreover, 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 made¹²⁷.

Where bills of exchange have been paid during the suspect period, the trustee may only obtain the restitution of the amounts paid under such bills of exchange from the initial beneficiaries of the bills of exchange (i.e. the initial creditors)¹²⁸. Even here, however, the trustee will only succeed against the original creditor if he can establish that the latter was aware of the fact that debtor has ceased its payments. The interests of third party holders of bills of exchange are protected.

Chapter 5.3. Legal effects of bankruptcy as such

§1. Non-fraudulent bankruptcy

1.1. Effects of a judgement declaim an individual or company bankrupt

The personal and extra-patrimonial rights of the bankrupt or of the member of the management of the bankrupt company are still maintained. Therefore no parental authority is lost.

The person's private life is still affected; as he must be constantly available to answer the questions of the official receiver, he cannot leave the country or be absent without authorization of the receiver. He also has to attend the meetings and respond to the invitations made by the official receiver or the trustees¹²⁹.

1.2. Legal obstacles to a fresh start?

1.2.1 The interdiction of exercise

The court that has declared the bankruptcy or, in case of a bankruptcy declared by a foreign court, the commercial court in Luxembourg, may prohibit the bankrupt person or the *de jure* or *de facto* members of the management of a company from performing a business activity¹³⁰. The aim of the measure is to take a person out of the economic arena because he is liable to act as he did before and cause problems in the commercial field again.

The following provisions have to be fulfilled:

- It has been requested by the trustee or the public prosecutor to the competent District Tribunal three years from the judgement declaring bankruptcy¹³¹. The trustee may ask both for an article 444-1 interdiction and for the application of other provisions such as article 495-1 of the Commercial Code, articles 59 and 192 of the law on commercial companies, or articles 1382 and 1483 of the Civil Code.
- The bankrupt person or director has contributed by a gross and indisputable mistake to the bankruptcy¹³², which a reasonably diligent and prudent manager would not have committed and one that damages the essential norms of social life (« Gross ») and that the mistake is incontestable (« Indisputable »).

For example, the bankrupt has not acknowledged the cessation of payments in the legal delays and has thus increased his liabilities, or he has not paid the debts to the public debtors, or he has continued a deficient exploitation in his own personal interest.

- It applies to anyone, who has been sentenced for fraudulent bankruptcy. It applies to all directors whether or not they are partners and whether or not they are apparent or covert, remunerated or not and whether or not they are in office at the time of the bankruptcy. A director, who is condemned on the basis of article 444-1 of the

Commercial Code does not have to be a trader nor to meet personally the conditions for bankruptcy.

The person is prohibited from performing a business activity, which includes the position of a director, manager, statutory auditor, independent auditor or any other activity that binds the company exercised directly or through an intermediary.

The duration of the sanction may be from one to twenty years at the discretion of the court. It can depend on the general attitude of the person and on the problems he has caused in the economic sector¹³³.

The interdiction ceases in the following hypothesis:

- the judgement declaring bankruptcy has been revoked;
- the bankrupt obtains the homologation of the composition after the bankruptcy; or
- the bankrupt obtains its rehabilitation.

1.2.2 The interdiction to act in justice

The person cannot act in justice except for purely personal actions (divorce) or for those against the trustee.

1.2.3 The publicity and records

As already mentioned above, most of the court decisions rendered in the various insolvency procedures have to be published either in the Memorial or in several newspapers designated by the relevant court decisions, such as:

- the judgement of the commercial court declaring the bankruptcy¹³⁴ ;
- the judgement of the commercial court determining the time of the cessation of payments¹³⁵

Both judgements are published by extract in some newspapers published in places close to the domicile of the bankrupt or close to his commercial establishments and which have been designated by the court.

These judgements are displayed in the hearing rooms of the commercial court for a period of three months¹³⁶.

Moreover, many documents have to be deposited with the Trade Register, such as the decision of interdiction to exercise some business activities¹³⁷. The public has the right of inspection of any company's file at the company's registry maintained either in Luxembourg or the district court of Diekirch. Copies of entries may be obtained at a small charge.

Certain documents have to be deposited with the Clerk office of the commercial court:

- the inventory drawn up by the trustee¹³⁸;
- the declarations of the claims and other documents attached to these declarations¹³⁹;
- a table mentioning the characteristics of the claims¹⁴⁰.

Moreover, a register of mortgages and charges is kept at the mortgage registration office (« Bureau des Hypothèques »). Mortgages are required to be registered in order to establish their

rank or relative rights of priority¹⁴¹. The details recorded in the register include the assets charged, the amount secured and the name of the creditor holding the charge.

Consequently, the publicity surrounding the procedure is another legal obstacle to a fresh start, particularly in a relatively small place like the Grand-Duchy of Luxembourg, where news is rapidly known by everyone. Following this publicity, a majority of the people are likely to lose their confidence in the entrepreneur involved in such a procedure.

1.2.4 The criminal sanction in case of simple bankruptcy

The sanction of simple bankruptcy is organised under Article 573 to Article 576 of the Commercial Code.

The trustee can lodge a criminal complaint against the debtor if he believes that the conditions for simple bankruptcy are met.

The trustee shall lodge the complaint either with the State Prosecutor or with the examining magistrate. Lodging the complaint with the Prosecutor enables the trustee to be heard as a witness.

The bankruptcy organised under Article 573 to Article 576 is not an alternative regime of the business entity described above but a criminal infraction linked to the condition of bankruptcy. Indeed, the declaration of bankruptcy may entail the discovery of breaches of law committed by the members of the management before the judgement declaring bankruptcy. Some of them enumerated in Article 57 to Article 578 are sanctioned pursuant to Article 489 and Article 490 of the Criminal Code. They are restrictively enumerated by the Commercial Code (Articles 573 to 578) such as the following:

- The accused has purchased some goods in order to resell them under the course, so that he puts the bankruptcy back;
- He has expended some major sums for activities such as gambling, fictitious operations on the Stock Exchange;
- He has paid or favoured a creditor at the detriment of the mass¹⁴² after the cessation of payments;
- He has not or in an incomplete or irregular way held the accountancy records;
- He has been declared bankrupt, after having not respected the provisions of the composition;
- He has not acknowledged the cessation of payments in due time or in a correct manner¹⁴³.

Relating to the sanction¹⁴⁴, simple bankruptcy is sanctioned by imprisonment for a term of between one month and two years.

The sued person is in most of cases the director or manager of the bankrupt company, but may also be an employee or a *de facto* director of the company. The acts, which are constitutive of the infraction, may be committed by an employee (accountant, financial director) without the knowledge of the directors of the company. This lack of control will not justify the condemnation of the directors of bankrupt company but may engage their civil responsibility.

However, some acts that may constitute the bankruptcy may only be reproached to the members of the management of the company. This is the case for the default of deposition of the bankruptcy.

§2. Fraudulent bankruptcy

The crime of fraudulent bankruptcy may be pronounced in the following cases:

- The person has removed records;
- He has falsified their content;
- He has embezzled or concealed a part of his assets; or
- He has stated that he was debtor of sums while he was not¹⁴⁵.

The fraudulent bankrupt is sentenced to confinement, which is a criminal penalty of imprisonment for a term of between five and ten years¹⁴⁶.

Chapter 5.4. « Excusability » following bankruptcy

§1. The composition after the bankruptcy

As mentioned above, if it appears that the assets will be sufficient, a composition after the bankruptcy procedure may be set up. This possibility is provided for under Article 508 to Article 519 of the Commercial Code.

The composition is not authorised if the bankrupt has been sentenced for fraudulent bankruptcy¹⁴⁷.

After the verification of the claims, the trustee proposes to the creditors an agreement in order to wipe off the liabilities of the bankrupt. This generally implies some partial renunciations from the creditors. If the propositions are accepted by the general assembly of the creditors, and homologated by the court¹⁴⁸, the bankrupt is replaced on the head of the business entity and can pursue his activities. The functions of the trustee cease¹⁴⁹.

The composition has to be declared null if after its homologation by the court, the bankrupt has been sentenced for fraudulent bankruptcy¹⁵⁰. Moreover, in case of non-execution by the bankrupt, the resolution of the composition may be requested or cancelled. In these cases, the trustees take their function again.

§2. The rehabilitation

The rehabilitation of the bankrupt has been organised under Articles 586 to 591 of the Commercial Code.

The bankrupt may ask for his rehabilitation to the Superior Court of Justice under the following provisions:

- The bankrupt has totally paid his debts (principals, interests and other expenses)¹⁵¹;
- The bankrupt is not a fraudulent bankrupt, a person sentenced for robbery, forgery, swindle or breach of trust, speculation, or a person (such as accountant), who has not

rendered and paid off his accounts. A simple bankrupt, who has born the sanction that he has been sentenced to, may be rehabilitated¹⁵².

This request is transmitted to the head of the prosecution department of the superior court of justice, who addresses the document to the following persons:

- the State prosecutor;
- the president of the commercial court of the domicile of the applicant; and
- the president of the commercial court of the district where the bankruptcy has taken place if the applicant has switched domicile since the beginning of the bankruptcy.

These persons are in charge of finding all information in order to check the authenticity of the facts described by the applicant¹⁵³.

A copy of the application is displayed during two months in the hearing rooms of the civil court and commercial courts and they are inserted in official documents¹⁵⁴.

Any creditor that was not totally paid by the applicant may ask for an injunction against the debtor¹⁵⁵.

After the two-month period, the public prosecutor and the chairman of the commercial court transmit all the information that they have obtained to the prosecutor of the superior court of justice, including the injunctions of the debtors and their opinion on this matter¹⁵⁶. The prosecutor of the superior court of justice renders his decision:

- If he rejects the application, the applicant has to wait one year before renewing his request;
- If the prosecutor accepts the application, the decision of rehabilitation will be addressed to the public prosecutor and to the chairman of the courts, where the request has been addressed. A public reading of the decision is performed and the decision is written on their registers¹⁵⁷.

The rehabilitation enables the bankrupt prohibited from exercising a business activity to start commercial activities again¹⁵⁸.

Chapter 5.5. Responsibility of the Company's management in case of bankruptcy

Luxembourg Law draws a distinction between:

- the civil liability of the ordinary law¹⁵⁹;
- the civil liability of the directors to the company for any misconduct in the management of the company's affairs¹⁶⁰;
- the civil liability of the directors to the company and third parties for damages resulting from the violation of the 1915 law or the articles of the company¹⁶¹;
- some special liabilities in case of bankruptcy¹⁶².

§1. The civil liability of the ordinary law

The directors or the managers of a company engage their responsibility in the conditions of the common law.

§2. The civil liability of the directors (or managers) to the company for any misconduct in the management of the company's affairs

The directors or the managers shall be liable to the company for the execution of the mandate given to them and for any misconduct in the management of the company's affairs¹⁶³. Breach of the mandate of the directors or managers of the company incurs the payment of damages.

Only the company is entitled to act on this basis (« actio Mandatis »). The decision to sue the directors must be taken by the general shareholder's meeting.

The applicant has to prove three elements:

- the fault, which the normally prudent and diligent person in the same circumstances would not have committed; the director has to act as a « bon père de famille », i.e. he has to manage the company with due diligence. Indeed, to determine whether there has been mismanagement the action of the directors is compared to the action of a "normally careful and conscientious director in the same circumstances". Therefore, the negligent management of the company leads to personal liability. Appreciation is more severe if the authorised director is an employee, and also for remunerated than non-remunerated directors;
- the damage that is suffered by the company or by third parties;
- the causal link between the previous damage and the contractual fault.

§3. The civil liability of the directors (or managers) to the company and third parties for damages resulting from the non-compliance of the 1915 law or the articles of the company

The directors (or the managers) shall be jointly and severally liable both towards the company and any third parties for damages resulting from the non-compliance of this law or the articles of the company.¹⁶⁴

The action on the basis of Article 59§2 has to be distinguished from the action based on Article 59§1 relating to the following items:

3.1. The initiators of the procedure

The company, any third party, the trustee of the company included, may initiate the action.

3.2. The cases in which such an action may be initiated

This action may only be initiated if the fault committed by the directors or the managers results from either:

- a non-compliance of the 1915 law such as failure to convene the annual general meeting, failure to publish the annual accounts; or

- a non-compliance of the articles of incorporation of the company such as operations outside of the social object of the company.

3.3. The legal basis of such an action

The legal basis of such an action depends on the initiator of the procedure:

- If the action is initiated by the company: this is a contractual responsibility;
- If the action is initiated by third parties. This is the aquiline responsibility.

A director can only be discharged from this liability if he can demonstrate that:

- He did not participate in the non-compliance;
- He had no committed any fault in relation thereto;
- He had no knowledge of the non-compliance or after having become aware of it, he informed shareholders at the next shareholder's meeting.

3.4. The effects of such an action

The directors or managers of the company are jointly liable. They shall be discharged from such liability in the case of a non-compliance, to which they were not a party provided no misconduct is attributable to them and they have reported such non-compliance to the first general meeting after they had acquired knowledge thereof.

§4. *Some special liabilities in case of bankruptcy*¹⁶⁵

4.1. « L'extension de la faillite de la société au maître de l'affaire »

A member of the management of a bankrupt company may himself be declared bankrupt under the following provisions:

- The person is any member of the management of a company (*de jure* or *de facto*, apparent or occult, remunerated or not, manager or director);
- The manager has performed one of these operations:
 - o He has conducted company business in his own personal interest;
 - o He has disposed of the assets of the company for his own personal interests;
 - o He has continued abusively in his own interests a deficient exploitation that could only lead to the cessation of payment of the bankrupt company¹⁶⁶.
- Due to constant case law, the physical person must meet the conditions for bankruptcy, i.e. he has suspended payments and his credits are exhausted. Moreover, he must be a trader¹⁶⁷.

The court benefits from a power of appreciation that enables it not to pronounce the bankruptcy of a manager, who deserves a certain indulgence, even if he has performed the incriminated operations.

The effect of this sanction is that the bankruptcy's liabilities include both personal liabilities and company's liabilities¹⁶⁸.

The bankruptcy may only be extended to the person managing the business to the extent that this latter is a trader, who has ceased his payments for less than six months after the judgement declaring the bankruptcy.

4.2. "L'action en complément de passif"

Furthermore, another sanction traditionally named « Action en complément de passif » may be pronounced by the court under the following provisions:

- It has been requested by the trustee;
- The person is any member of the management of a company (*de jure* or *de facto*, apparent or occult, remunerated or not, manager or director);
- In the course of the bankruptcy, it becomes apparent that the assets of the bankrupt company are insufficient to pay all the claims;
- The members of the management have committed gross and indisputable mistakes having contributed to the bankruptcy¹⁶⁹;
- The action has been brought within three years from the date, on which the final account of creditors' claims has been presented in the bankruptcy procedure.
In case of termination or cancellation of the composition, prescription, which was suspended for the time of the composition, starts running again. The delay for exercising an action can however not be less than one year¹⁷⁰.

There is no presumption of liability against the company's directors. Their mistake must be proved. The mistake must be sufficiently gross to have incurred or contributed in a decisive way to the company's bankruptcy. However, the mistake does not need to have a causal link with the insufficiency of assets, only with bankruptcy. It has to be proved that the mistake brought about the bankruptcy. The judge is free to evaluate the mistake and its effect on bankruptcy and insufficiency of assets.

The level of the contribution of the directors is left to the court's judgement in the light of the fault. The court decides the sum to be paid by the manager and has a discretionary power to declare the action founded or not; the efforts of the manager to try to save the company are taken into consideration.

This provision confirmed a case law in Luxembourg, which had stated until 1992 according to similar principles. In a case dated 1997¹⁷¹, the tribunal did not expressly refer to article 495-1 of the Commercial Code (the article did not exist at the time the trustee introduced his action), yet it mentioned the fault committed in the management of the company, the date when the negligent events happened, and sentenced the debtor to take over the company's liabilities accrued to the detriment of the bankrupt companies since the date of suspension of payments.

TITLE 6. PROSPECTS AND RECOMMENDATIONS

Chapter 6.1. Recommendations for improvement of the legislation

§1. Increase the minimum share capital required?

The majority of the companies, which have been declared bankrupt, own a share capital, whose amount is limited to that which is legally required.

In light of this, it may be considered whether Luxembourg should follow the example of the Belgian regulator and increase the minimum capital requirement. The working group, who drew up an inter-ministerial report on bankruptcy in 1994, was of the opinion that increasing the minimum of share capital from the current amount of LUF 500.000 (€1239,47) to LUF 750.000 (€ 18592,01) would have a negligible impact. Moreover, an increase in the minimum share capital would act as a severe obstacle to the freedom of establishment and to the development of trade in general. It would also be nonsense, as the importance of the share capital depends on the social object of the company. A service company does not require huge amounts of funds but certain production companies having important infrastructure may well require more funds.

However, the above-mentioned working group has suggested that the report of the auditor in cases of contribution of assets required for a public company limited by shares should also be requested for private limited liability company's. This would cause an increase in costs but would provide a certain guarantee with respect to the existence and the consistence of the share capital of the new company. This should be done by way of a change to Article 26-1 of the 1915 Law.

Another solution would be to take as an example what is done in Germany. This consists of treating debts and credits granted by important shareholders of a company declared bankrupt as debts subordinated to debts from other debtors that are not shareholders, in cases where it has been noticed that the company had a share capital obviously insufficient regarding the social object of the company.

Lastly, we can hope that the number of bankruptcies caused by under-capitalization will decrease with the setting-up of the « Société nationale de crédit et d'investissement » (hereinafter « national company of credit and investment ») in the framework of the action plan in support of the « Petites et Moyennes Entreprises » (« PME » hereinafter « Small and Medium Enterprises », SMEs), which will enable the young entrepreneurs to obtain capital that is often refused by the banks.

§2. A requirement to draw up a financial plan?

We are not convinced that the requirement of a financial plan should be mandatory each time a company is set up in Luxembourg.

Currently, there is an obligation to draw up a three-year financial plan for companies that plan to exercise an activity in the financial sector. An administrative authority verifies the realism of the proposed financial plan before granting the authorization to exercise the financial activity.

If a financial plan is required for commercial companies, the Ministère des Classes Moyennes that is the competent authority to deliver the trading licenses would have to control this document. This control function is not within the scope or remit of this authority. In the absence of efficient control of the concordance of the financial plan with the future social object of the

applicant, the requirement of a financial plan would not have an impact on the prevention of the bankruptcy. The sole effect of this measure would be to increase the responsibility of the founders of the new company, when they are declared bankrupt little time shortly after establishing the company.

§3. A new procedure for the obtaining a trade license?

3.1 The current control of the Ministry of Classes Moyennes is relatively formal

The trade license is issued by the Ministère des Classes Moyennes, after having obtained the opinion of a committee, which considers the applicant's qualifications, professional good standing and respectability.

The Ministry only exercises control if the elements required by the law dated December 28, 1998 regulating the access to the professions of artisan, trader, industrial and certain liberal professions (« the 1988 Law ») exist. A copy of the said giro receipt must be enclosed with the written application as well as with an original of the following documents:

- detailed information regarding the nature and the characteristic of the activities;
- copy or draft of the articles of the parent company;
- a recent extract of the police record;
- a certificate of non-bankruptcy from the managing director, which should not be limited in either time or jurisdiction. This certificate must be made on oath before a Luxembourg public notary of the applicant's choice. The certificate must state that the applicant has never been declared bankrupt and has never been a director of a company, which has been declared bankrupt;
- a certified copy of the managing director's educational diploma(s).
- a certificate of work experience from the managing director in the form of a European Community certificate based on the European Community directive prevailing in the present matter and stating an experience of at least 3 years, delivered by the chamber of commerce of the city where the company was incorporated.

The Ministère des Classes Moyennes may require complementary documentation according to each specific case but it is an unduly arduous process.

In those cases where the person in charge of the technical management of the requiring company has already managed or administrated a company declared bankrupt, the Ministère des Classes Moyennes, before granting its trade license, transmits a request of advice to the Ministry of Justice regarding the eventual responsibility of the manager in the bankruptcy of the previous company.

This request is transmitted to the prosecution department. This latter transmits in written to the trustee of the bankrupt company a questionnaire relating to the reasons and the importance of the bankruptcy for which he is trustee, on the origin and the reasons of the cessation of the payments and the exhausting of the credit, and on the role of the manager, who has requested the new trade license.

For the following reasons, the questionnaires are often not completed in the best possible manner:

- The trustees do not have enough information (sometimes none or few accountancy records for the company). Consequently, they do not give precise answers in order to avoid assuming any responsibility.
- Very often, the trustees are chosen from the list II of the lawyers and have little experience these matters;
- The tariff of remuneration currently applied since 1979 is not in commiserate with the work and the responsibility linked to the liquidation of bankruptcies and does not incite the trustees to perform their work with a high level assiduous attention.

In these circumstances, when the advice of the prosecution department is solicited (around fifty cases per year), it is almost impossibility to give a clear negative opinion on the manager. The negative opinions are very seldom given.

Moreover, the opinion of the trustees often takes time to be given. Consequently, the Prosecution department cannot give its advice within a reasonable period enabling the Ministère des Classes Moyennes to take a position in the required period of three months.

This system is not satisfactory. More systematic control of the declared bankruptcies should be organized, even if no new trading license is requested. An analysis of the reasons for the bankruptcy should be carried out, so that the people that should be sentenced to judiciary interdiction¹⁷² may be detected. Then, the Ministère des Classes Moyennes would only have to consult the list of the interdictions and would base its refusal to grant the trading license on this list. This would simplify the work of the Ministère des Classes Moyennes and make the process faster.

The procedures in order to deliver the judicial interdictions would have to be held quickly. The Working Group of 1994 proposes the following measures:

- Increasing of the effectiveness of the Prosecution department and of the services of the judiciary police;
- Merger of the various questionnaires sent to the trustees into one unique questionnaire that would have to be filed by the trustees in virtue of a new article of the Trade Code;
- Formation of the trustees and readjustment of their remuneration.

§4. Setting-up of a commission composed of members of all administrations, whose debts are privileged

Moreover, it would be useful to establish a commission including representatives of all public administrations whose debts are privileged. This commission would have to examine the situation of every physical or moral person, who was in delay with the payment of a debt. This commission would exchange some information with the Prosecution department. This latter could obtain on a simple request to the commission all necessary information on the companies in difficulties and would, if the case may be, start some procedures.

For this project, it would be necessary to establish a solid legal basis.

§5. The take over of trade license in case of non-payment of the social and tax charges

The Ministère des Classes Moyennes can take over the trade license of any person who does not pay his social and fiscal charges (Article 2 Law 1988). But this possibility is very seldom used. It would be interesting if the Ministry could take over the license in cases of significant non-payment of the above-mentioned privileged debts. This would be possible if better cooperation between the public administrations and the Ministère des Classes Moyennes could be ensured.

§6. Setting up of a prevention cell

In France, the majority of courts have set up certain “cellules de prevention” (prevention cell) that are composed of one or several judges convening the entrepreneurs, who experience financial difficulties in order to know the reasons for their difficulties and the planned actions to solve them. The significance of this procedure is that it is completely confidential. The entrepreneur may pursue its activity without losing his credibility vis-à-vis his creditors and his clients.

§7. Cleaning the business environment by sanctioning more systematically the persons responsible

We are of the opinion that the situation in Luxembourg would be improved if the courts could pronounce more systematically the interdiction of exercising a commercial activity in cases of organized bankruptcy. Indeed, it may be stated that some persons are very often involved in several successive bankruptcies. It would be better if they were more severely sanctioned in order to “clean up” the business environment.

Chapter 6.2. Prospects

§1. The Trade Register on line

With the setting-up of the Trade Register on Internet and the proposition of the inter-ministerial working group « Centrale de Bilans », it will have a normalization, which will enable an improved follow-up of the accountant obligations imposed on traders. This will be an efficient instrument of control for the economical Prosecution Department.

§2. The commercial court initiator of the controlled management procedure

A controlled management procedure intended at the initiative of the Trade Tribunal could be planned to be put in place. Currently, the law only views this possibility as arising at the request of physical or moral persons.

The investigation powers of the tribunal should be increased.

But it has to be noted that the procedure is both arduous and expensive.

The inter-ministerial working group (members of the Ministers of Justice, Labour, Economy, Finance, Social and « Classes Moyennes ») has suggested the following measures:

- Setting-up of a specialised service for the prevention of bankruptcies, included into the services of the public prosecution (named « service de prévention des faillites »)
- Increase of the minimum share capital
- Inclusion of a specific right of ownership (« clause de réserve de propriété ») in order to protect the suppliers against substantial losses in case of bankruptcy of the company;

- Change in the interpretation of the privilege of the tax administration against all other creditors;
- Setting-up of a central statistical information office and quantitative as well as qualitative databases (with the following information: registered name, social object, share capital, form of the company).
- Closer co-operation between the administrations concerned.

§3. *Reinforcement of the prevention procedures*

A working group instituted close to the Ministry of Justice is currently in charge of making some proposals. Among others, it would be planned to change the procedure of the controlled management by bringing more flexibility and by giving to the Commercial Trade a more active role.

TITLE 7. STATE OF KNOWLEDGE

- The fifth annual report of the European Observatory for Small and Medium Sized Enterprises, Chapter VII: failures and bankruptcies (contribution of the centre de promotion et de recherche Chambre des Métiers du Grand Duché de Luxembourg);
- Legal chronik in the Merkur 2000 « La réserve de propriété » ;
- Bulletin du Cercle François Laurent 1994, Bulletin III, « Aspects nouveaux du Droit de la Faillite suite à la loi du 21 juillet 1992 » written by Maître Gaston STEIN and M. Jeannot NIES ;
- Codex.
- « European Corporate Insolvency: A Practical Guide »_edited by Harry Rajak, Peter Horrock and Joe Bannister;
- The newspaper « Le Jeudi ».

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- ¹ Statistics issued by the “Chambre de Commerce” of Luxembourg
² Source the newspaper “Le Jeudi” dated February 2002
³ Ibid (Michel Former, managing adviser in the “Chambre de Commerce”
⁴ Article 1 of the Commercial Code
⁵ “Le Jeudi” dated February 14, 2002
⁶⁶ Passage 1 Place d’Armes, L-1136 Luxembourg
⁷ Art. 163, 3° law 1915
⁸ Term defined in the Part 2 of the report
⁹ Ibid
¹⁰ Ibid
¹¹ Article 2§4 of the 1886 Law
¹² Article 3 of the 1886 Law
¹³ Term defined in the Part 2 of the report
¹⁴ Article 594§1 of the Commercial Code
¹⁵ Article 595 of the Commercial Code
¹⁶ Article 596 of the Commercial Code
¹⁷ Article 592 of the Commercial Code
¹⁸ Article 598 of the Commercial Code
¹⁹ Article 599§2 et §3 of the Commercial Code
²⁰ Article 593 of the Commercial Code
²¹ Term defined in the Part 2 of the report
²² Article 594 of the Commercial Code
²³ Article 595§5 and Article 600§2 of the Commercial Code
²⁴ Article 602§1 of the Commercial Code
²⁵ Article 603§3 of the Commercial Code
²⁶ Article 603§4 of the Commercial Code
²⁷ Articles 597 to 599 of the Commercial Code
²⁸ Article 596§1 of the Commercial Code
²⁹ Article 605 of the Commercial Code
³⁰ Article 606 of the Commercial Code
³¹ Article 603 of the Commercial Code
³² Article 600§1 of the Commercial Code
³³ Article 600§3 of the Commercial Code
³⁴ Article 608 of the Commercial Code
³⁵ Article 607 of the Commercial Code
³⁶ Article 60(8) of the Law dated April 5, 1993
³⁷ Article 601 of the Commercial Code
³⁸ Article 596 of the Commercial Code
³⁹ Article 602§4 of the Commercial Code
⁴⁰ Article 1§2 of the 1935 Decree
⁴¹ Article 2§1 of the 1935 Decree
⁴² Article 2§2 of the 1935 Decree
⁴³ Article 2§3 of the 1935 Decree
⁴⁴ Article 2§4 of the 1935 Decree
⁴⁵ Article 3§1 of the 1935 Decree
⁴⁶ Article 4§1 of the 1935 Decree
⁴⁷ Article 4§2 of the 1935 Decree
⁴⁸ Article 4 § 1 of the 1935 Decree
⁴⁹ Article 5§1 of the 1935 Decree
⁵⁰ Article 5§4 of the 1935 Decree
⁵¹ Article 6 of the 1935 Decree
⁵² Article 5§2 of the 1935 Decree
⁵³ Article 8§1 of the 1935 Decree

⁵⁴ Article 8§2 of the 1935 Decree
⁵⁵ Article 9 of the 1935 Decree
⁵⁶ Article 1§1 of the 1935 Decree
⁵⁷ Article 1§4 of the 1935 Decree
⁵⁸ Term defined in Part 2 of the report
⁵⁹ Article 1§1 of the 1935 Decree
⁶⁰ Article 3§2 of the 1935 Decree
⁶¹ Article 5§2 of the 1935 Decree
⁶² currently required by Articles 3 and 4 of the the 1935 Decree
⁶³ Article 10 of the 1935 Decree
⁶⁴ Article 11§1 and §2 of the 1935 Decree
⁶⁵ Article 11§1 of the Arrêté Grand-Ducal dated May 24, 1935
⁶⁶ Article 8§2 of the Arrêté Grand-Ducal dated May 24, 1935
⁶⁷ Article 12§1 of the 1935 Decree
⁶⁸ Article 4§1 of the 1935 Decree
⁶⁹ Article 10 of the 1935 Decree
⁷⁰ Article 60(2) of the law dated April 5, 1993
⁷¹ Article 60(5) of the law dated April 5, 1993
⁷² Article 60(4) of the law dated April 5, 1993
⁷³ Article 60(15) of the law dated April 5, 1993
⁷⁴ Article 60(6bis) of the law dated April 5, 1993
⁷⁵ Article 61-1 of the law dated April 5, 1993
⁷⁶
⁷⁷ Article 60(12) and (13) of the law dated April 5, 1993
⁷⁸ Article 60(18) of the law dated April 5, 1993
⁷⁹ Term defined in the Part 2 of the report
⁸⁰ Article 437§1 of the Commercial Code
⁸¹ Article 437 of the Commercial Code
⁸² Article 442§2 of the Commercial Code
⁸³ Article 442 §3 of the Commercial Code
⁸⁴ Article 613 of the Commercial Code
⁸⁵ Article 440 and 635 of the Commercial Code
⁸⁶ Article 466§1 of the Commercial Code
⁸⁷ Article 463 of the Commercial Code
⁸⁸ Article 466§1 of the Commercial Code
⁸⁹ Article 455 and 456§1 of the Commercial Code
⁹⁰ Article 456 of the Commercial Code,
⁹¹ Article 470 of the Commercial Code
⁹² Article 464 of the Commercial Code
⁹³ Article 496§1 and Article 466§1 of the Commercial Code
⁹⁴ Article 504 of the Commercial Code
⁹⁵ Article 442 of the Commercial Code
⁹⁶ Ibid
⁹⁷ Ibid
⁹⁸ Article 440 of the Commercial Code
⁹⁹ Articles 8 and 9 of the Commercial Code and Article 441 of the Commercial Code
¹⁰⁰ Article 574 4) of the Commercial Code
¹⁰¹ Article 466§1 of the Commercial Code
¹⁰² Article 466 of the Commercial Code
¹⁰³ Article 466§2 of the Commercial Code
¹⁰⁴ Article 472 of the Commercial Code
¹⁰⁵ Article 488 and 489 of the Commercial Code
¹⁰⁶ Article 484 of the Commercial Code
¹⁰⁷ Article 477 of the Commercial Code
¹⁰⁸ Article 479 of the Commercial Code

109 Article 494§1 of the Commercial Code
110 Article 494 §2of the Commercial Code
111 Article 536 of the Commercial Code
112 Term defined in Part 2 of the report
113 Term defined in Part 2 of the report
114 Article 528 of the Commercial Code
115 Article 533 of the Commercial Code
116 Article 451 of the Commercial Code
117 Article 452 to 454 of the Commercial Code
118 Article 442 paragraph 4 of the Commercial Code
119 Term defined in Part 2 of the report
120 Article 442 paragraph 2 of the Commercial Code
121 Article 442, paragraph 4
122 Article 17 of the 1935 Decree
123 Article 445 of the Commercial Code
124 Ibid
125 Article 446 of the Commercial Code
126 Article 447 of the Commercial Code
127 Article 448 of the Commercial Code
128 Article 449 of the Commercial Code
129 Article 482 of the Commercial Code
130 Article 444-1 of the Commercial Code
131 Article 444-1 §2 of the Commercial Code
132 Article 444-1 §1 of the Commercial Code
133 Article 444-1 §3 of the Commercial Code
134 Article 466 of the Commercial Code
135 Article 472 of the Commercial Code
136 Article 472 and Article 496 of the Commercial Code
137 Article 444-1 of the Commercial Code
138 Article 489 of the Commercial Code
139 Article 506 of the Commercial Code
140 Article 507 of the Commercial Code
141 Article 487 of the Commercial Code
142 Article 573 of the Commercial Code
143 Article 574 of the Commercial Code
144 Article 489 of the Criminal Code
145 Article 577 of the Commercial Code
146 Article 489 of the Criminal Code
147 Article 514 of the Commercial Code
148 Article 518 and Article 519 of the Commercial Code
149 Article 519 of the Commercial Code
150 Article 521 of the Commercial Code
151 Article 586 of the Commercial Code
152 Article 591§1 and §2 of the Commercial Code
153 Article 587§2 of the Commercial Code
154 Article 587§3 of the Commercial Code
155 Article 588 of the Commercial Code
156 Article 589 of the Commercial Code
157 Article 590 of the Commercial Code
158 Article 444-1 of the Commercial Code
159 Articles 1382 and 1383 of the Civil Code
160 Article 59 §1 and Article 192 of the Commercial Code
161 Article 59 §2 and Article 192 of the Commercial Code
162 Articles 495 and Article 495-1 of the Commercial Code
163 Article 59 §1 of the Commercial Code and Article 192

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- ¹⁶⁴ Article 59 § 2 and Article 192 of the Commercial Code
- ¹⁶⁵ Articles 495 and Article 495-1 of the Commercial Code
- ¹⁶⁶ Article 495§1 of the Commercial Code
- ¹⁶⁷ BNS Center Sarl / Büchler, January 10, 1992 and September, 19 1997
- ¹⁶⁸ Article 495§2 of the Commercial Code
- ¹⁶⁹ Article 495-1§1 of the Commercial Code
- ¹⁷⁰ Article 495§2 of the Commercial Code
- ¹⁷¹ BNS Center Sarl / Büchler, 19 September 1997
- ¹⁷² Article 444-1 of the Commercial Code