

International Corporate Rescue

Published by

Chase Cambria Company (Publishing) Ltd



www.chasecambria.com



Published by:

Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom
www.chasecambria.com

Annual Subscriptions:

Subscription prices 2024 (6 issues)

Print or electronic access:

EUR 730.00 / USD 890.00 / GBP 560.00

VAT will be charged on online subscriptions.

For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

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Differentiated Treatment of Creditors under Luxembourg's New Restructuring Law

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Synopsis

As Thomas Jefferson once said, '*there is nothing more unequal than the equal treatment of unequal people*'. This wisdom holds true in the business world, where the diverse interests of creditors must often be balanced, especially in the context of corporate restructuring. Luxembourg's legislator has long taken care to ensure that creditors' claims are handled according to a hierarchy that sometimes favours weaker parties, such as employees, particularly in bankruptcy or reorganisation scenarios.

On 7 August 2023, Luxembourg implemented the Directive (EU) 2019/1023 on preventive restructuring frameworks through the 'Law on the Preservation of Enterprises and Modernisation of the Bankruptcy Act' (hereafter the 'Restructuring Act'¹). This law aims to enhance the restructuring framework to provide businesses in financial distress with the tools to survive, preserve jobs, and maximise value for creditors. The law became effective on 1 November 2023 and provides a court-led restructuring process (*réorganisation judiciaire*) designed to allow businesses facing financial difficulty to reorganise while maintaining business continuity.

For the purposes of this article, any reference to restructuring procedures refers exclusively to court-led restructuring (*réorganisation judiciaire*), and does not include out-of-court restructuring (*réorganisation par accord amiable*).

The initiation of a court-led restructuring procedure may be granted for one of the following objectives:

- The granting of a stay of individual enforcement actions to facilitate negotiations and the conclusion of an out-of-court agreement between the debtor and two or more creditors;
- The approval by creditors of a restructuring plan prepared by the debtor, who may be assisted by a judicial representative (*mandataire judiciaire*);

- The sale, through a judicial decision, of all or part of the debtor's assets or business activities to one or more third parties.

In practice, during the first few months following the implementation of the Restructuring Act, questions have arisen regarding the classification of creditors and the possibility of differentiating their treatment under the restructuring plan.

This article focuses on the classification of creditors under the Restructuring Act, exploring the possibility of differentiated treatment, and outlines the process for the adoption and approval of a restructuring plan, including through cross-class cram down mechanisms.²

I. The concept of affected claims and the classes of affected creditors

Upon the debtor's submission of an application for restructuring to the Luxembourg court, the court must review the application within fifteen days of its receipt by the court registry. A ruling (the 'Opening Decision') will be issued within eight days after this review. If the court grants the restructuring procedure, the Opening Decision will set the duration of the suspension of individual enforcement actions. Additionally, if the restructuring procedure seeks creditor approval for a restructuring plan, the Opening Decision (or a subsequent court decision) will specify the time, date, and location for the voting and homologation of the restructuring plan.

In accordance with Article 39 of the Restructuring Act, within fourteen days of the Opening Decision, the debtor is required to notify each affected creditor (*créanciers sursitaires*) of (i) the amount of the creditor's claim(s) as recorded in the debtor's books, (ii) any property owned by the creditor or subject to a security interest or lien securing the claim(s), and (iii) the creditor's classification.

Notes

- 1 Loi du 7 août 2023 relative à la préservation des entreprises et portant modernisation du droit de la faillite, <http://data.legilux.public.lu/eli/etat/leg/loi/2023/08/07/a521/jo>.
- 2 For more information on judicial restructuring, the stay of individual enforcement actions and the rights of affected creditors: Restructuring and Insolvency Jurisdiction Guide: Luxembourg, Ogier.

Creditors have the right to challenge the amount, nature, or classification of their claim(s) or request the admission of their claim(s) into the restructuring procedure. Such challenges must be submitted to the court at least one month before the hearing on the restructuring plan. Failure to challenge by this deadline will result in the creditor being allowed to vote and treated under the restructuring plan only for the amount initially communicated by the debtor. The court may modify or admit the creditor's claim(s) or classification based on the challenge. If the court is not competent to resolve the dispute, it will provisionally determine the amount and quality of the claim and defer the matter to the competent court. If the court has jurisdiction but anticipates a delayed decision, it will also determine the claim provisionally.

The classification of creditors is mandated by the Directive on Restructuring and Insolvency, which states that affected parties must be grouped into separate classes reflecting the nature and seniority of their claims. This is to ensure equitable treatment of creditors and the adoption of the restructuring plan without unfair prejudice. At a minimum, secured and unsecured creditors must always be treated in separate classes.

Class formation is crucial to the restructuring process, influencing the economic treatment of creditors' claims and the adoption of the plan. In compliance with the Directive, Luxembourg law establishes two classes of creditors: (i) ordinary affected creditors (*créanciers sursitaires ordinaires*) and (ii) extraordinary affected creditors (*créanciers sursitaires extraordinaires*).

The concept of 'affected claims' (*créances sursitaires*) underpins class formation. These include all claims, except salary claims, that arose before the opening of the judicial restructuring procedure or resulted from the filing of the petition or judicial decisions in the restructuring process. Examples of affected claims include:

- Claims arising from termination clauses triggered by the restructuring procedure,
- Claims for damages due to the debtor's cessation of performance under an ongoing contract,
- Claims for services performed before the restructuring procedure in ongoing contracts of successive performance,
- Contingent claims predating the restructuring procedure.

Affected claims are generally subject to the stay on individual enforcement actions imposed by the court at the outset of the restructuring procedure.

Extraordinary affected claims (*créances sursitaires extraordinaires*) are those secured by special privileges or mortgages, claims of creditor-owners, or claims by tax authorities and social security. Creditor-owners are unique in that they hold both a claim and ownership of tangible movable property not in their possession, which serves as security.

Ordinary affected claims (*créances sursitaires ordinaires*) encompass all other affected claims that do not qualify as extraordinary.

Accordingly, extraordinary affected creditors (*créanciers sursitaires extraordinaires*) hold extraordinary affected claims, while ordinary affected creditors (*créanciers sursitaires ordinaires*) hold ordinary affected claims.

It is worth noting that while the Directive permits workers and, in some cases, equity-holders to vote on the restructuring plan if they are affected creditors, Luxembourg has not granted equity-holders voting rights. This decision simplifies the approval of plans involving debt-to-equity swaps, typically opposed by equity-holders facing dilution. This approach aligns with the Directive's goal of maximising value for creditors, rather than current equity-holders. Workers are explicitly excluded from the definition of affected creditors and cannot vote, but the Restructuring Act still requires that the restructuring plan outline procedures for informing and consulting employee representatives.

2. The possibility to create categories of creditors for differentiated economic treatment under the restructuring plan

Although the Restructuring Act does not permit the creation of additional classes of creditors beyond the categories of extraordinary affected creditors and ordinary affected creditors for the purpose of voting on the restructuring plan, it allows for the creation of categories of claims or interests affected by the restructuring plan, which can be treated differently. However, creditors within the same category must be treated equally and in proportion to the value of their claim.³

To clarify, while the formation of creditor classes affects voting on the restructuring plan, the creation of claim categories affects the economic treatment of creditors' claims and interests under the plan.

The classification of claims and interests for differentiated treatment must be based on 'objective criteria', such as the nature and amount of the claims or interests. If not justified by objective criteria, there is a risk that the court will refuse to homologate the

Notes

3 Articles 41.(2)5° and 43§2 of the Restructuring Law reflect the intent of articles 8.1(d) and 10.2(b) of the Directive on Restructuring and Insolvency.

restructuring plan due to a breach of public order, specifically the principle of equal treatment of creditors.

What constitutes 'objective criteria'? In the absence of detailed guidance from the Luxembourg legislator in the preparatory works of the Restructuring Act, we can look to Belgian doctrine and case law, given the similarities between the Restructuring Act and its Belgian counterpart.

To conform with the principle of equal treatment and avoid rejection of the plan on public order grounds, the following rules for 'objective criteria' should be observed:⁴

- Claims may be categorised based on: (a) their amount; (b) their nature (e.g., principal vs. interest, public claims, supplier claims, bank claims, shareholder claims, etc.); (c) whether they are strategic for the debtor's business, i.e., claims of essential business partners necessary for the continuation of operations and financial recovery, versus other claims. Differentiated treatment of strategic creditors must be supported by evidence that they may cease cooperation with the debtor if treated equally with non-strategic creditors.⁵
- The court will evaluate whether a 'reasonable justification' exists for the differentiated treatment. This justification must consider the aims and outcomes of the treatment, such as preserving the debtor's assets, ensuring business continuity, and creditor agreement to the restructuring plan. If there is no reasonable proportionality between the treatment and its aims (e.g., favouring some creditors at the expense of others), it would violate the principle of equal treatment.⁶

A pre-existing subordination or intercreditor agreement could be challenged if the differentiated treatment lacks reasonable justification and appears artificial. However, the decision will depend on the facts of each case.

3. The adoption of the plan

3.1 Process for adopting the plan

Once the restructuring plan is prepared, the debtor must file it with the court registry. Affected creditors listed in the plan will be notified that the plan is available for review at the court registry, along with the time, date, and location of the hearing for the vote. The hearing must be held at least 15 days after this notification.

Only ordinary and extraordinary affected creditors, whose rights are impacted by the plan, are eligible to vote on its adoption. A double majority is required for approval: a majority of creditors within each class, representing at least half of the total principal debt owed, must agree. Only claims listed in the court registry or provisionally admitted will count toward this majority.

3.2 Voting exclusions and the best-interest-of-creditors test

Creditors who do not participate in the vote (either in person or by representation) will not be counted toward the voting majorities. The best-interest-of-creditors test (*critère du meilleur intérêt des créanciers*).

Any dissenting creditor can contest the plan, arguing it does not meet the best-interest-of-creditors test. This test, defined in Whereas (52) of the Directive on Restructuring and Insolvency, means that no dissenting creditor should be worse off under the plan than in liquidation or any alternative scenario if the restructuring plan were not confirmed. The Restructuring Act incorporates this definition without further clarification.

3.3 The homologation of the plan

The judge will decide whether to homologate the restructuring plan within 15 days of the hearing, and in any event, before the stay on individual enforcement actions expires.

If the plan is validly adopted, the judge's review will be limited to assessing:

- (a) Whether all legal formalities of the restructuring procedure were observed;
- (b) Whether any new financing under the plan is necessary for its implementation and does not excessively harm creditor interests;
- (c) Whether the plan meets the best-interest-of-creditors test;
- (d) Whether the plan violates public order, particularly in cases of differentiated creditor treatment, by breaching the principle of equal treatment;
- (e) Whether the plan offers a reasonable chance of avoiding the debtor's insolvency or preserving the business's viability.

If the court finds issues with points (a) to (d), it may allow the debtor to propose a revised plan for creditor approval.

Notes

4 For an in-depth review of Belgian case law on this matter: Alter, C. and Pletinckx, Z., 'Section 3 – La réorganisation judiciaire par accord collectif', in *Insolvabilité des entreprises*, 1st edn, Bruxelles, Larcier, 2019, pp. 324-404.

5 Court of Appeal (Brussels), 4 October 2012, R.G. n° 2012/QR/52.

6 Court of Cassation (Belgium), 7 February 2013, J.L.M.B., 2013, p. 1510.

Once homologated, the restructuring plan becomes binding on all affected creditors.

4. Cross class cram down

Pursuant to Article 50, paragraph 2 of the Restructuring Act, and in line with the objectives of the Directive on Restructuring and Insolvency,⁷ a restructuring plan that has not been validly adopted under the requirements of the Restructuring Act may still be homologated at the request or with the consent of the debtor. In such cases, the plan can be imposed on dissenting classes of affected creditors, provided it was approved by at least one class of creditors entitled to vote on the plan and the following conditions are met:

- (a) All the requirements for the homologation of the restructuring plan, as outlined above, are satisfied;
- (b) No class of creditors may recover more than the full amount of their claims and interests under the restructuring plan;
- (c) If the class of extraordinary affected creditors is the dissenting class (i.e., the plan was approved only by the class of ordinary affected creditors), the plan must ensure that extraordinary affected creditors are treated more favourably than ordinary affected creditors. In practice, the Luxembourg legislator has adopted the ‘absolute priority rule’ under the Restructuring Act.⁸

This process, known as a ‘cross-class cram down’, allows the court to homologate the restructuring plan even over the objection of certain creditor classes, as long as these conditions are met. In such cases, the court cannot refuse the homologation of the plan.

The restructuring procedure will conclude with the court’s decision on the homologation of the plan, whether that decision approves or rejects the homologation. The court’s decision will be published in the Luxembourg Official Electronic Gazette (*Recueil Electronique des Sociétés et Associations*) and notified to the creditors by the court registry.

While the court’s decision on the homologation cannot be directly opposed, an appeal may be filed within a shortened timeframe of fifteen (15) days following the notification of the decision. If the court refuses to homologate the plan, any appeal will have a suspensive effect on the judgment.

5. Conclusion

The Luxembourg Restructuring Act provides a robust framework for judicial restructuring, offering businesses the opportunity to reorganise while balancing the rights of creditors. The law allows for differentiated treatment of creditors under restructuring plans, but such differentiation must be justified by objective criteria. The courts are tasked with ensuring that any such treatment complies with principles of fairness and equality, setting the stage for a new era of business reorganisation in Luxembourg.

Notes

⁷ In this respect, see Whereas (53) to (55) of the Directive on Restructuring and Insolvency.

⁸ In this respect, see: Mastrullo, T., ‘Panorama du droit luxembourgeois de la prévention et de la restructuration après la loi du 7 août 2023 sur la préservation des entreprises’, *JN Insolv.*, 2024/1-2, pp. 209-216, §49.

International Corporate Rescue

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