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ARTICLE

New Luxembourg Restructuring Law and the Double Luxco: An Im-perfect Match?

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Synopsis

Much ink has been spilled since the entry into force of the long-awaited Luxembourg law on business preservation and modernisation of bankruptcy law. This law, which came into force on 1 November 2023 (the 'Restructuring Law'), is revamping the existing but rarely used restructuring tools and introducing new preventive and reorganisation measures. We will analyse in this article if and how the new restructuring tools fit in the well-established and creditor-friendly legislative framework on financial collateral arrangements and the popular use of Double Luxco structures.[2]

A. Introduction

The so-called 'Double Luxco' structures were traditionally tax incentivised but for more than a decade now, the very large implementation by Luxembourg of the Financial Collateral Directive[3] has made it a household name for investors looking into European groups because of its very robust and court-tested security enforcement options. Luxembourg nowadays is as well known in the European finance and private equity sector for being a popular location to set up funds as it is for the use in financings and restructurings of its Double Luxcos (also commonly referred to 'Luxembourg pre-pack' in the restructuring world).

Double Luxcos are very often used by investors/lenders/creditors to ensure that they can enforce and take control over their defaulting debtors despite lending or being debt-exposed to groups located in 'difficult security jurisdictions'. Such jurisdictions would typically include continental European jurisdictions, where for instance there is no precedent of a security enforcement having occurred, where a lengthy court process is needed, or where the restructuring options available to debtor companies allow a stay on enforcement to be easily obtained. In the same vein,[4] the Double Luxco structure allows corporate groups located in more debtor friendly jurisdictions and in a market where new financings are very costly and hard to get, to find the much needed liquidities. In the current market conditions, this is obviously critical on (i) investors/lenders/noteholders' side to get sufficient comfort, should the borrowing group become troubled and (ii) debtor side to find refinancing options.

Traditionally, the above restrictions and concerns of investors/lenders/noteholders were not very relevant in Luxembourg because of the very creditor friendly and bankruptcy remote security legislation but also because the only realistic Luxembourg insolvency proceeding a distressed debtor could opt for was a bankruptcy liquidation fully controlled by the Luxembourg court. Now that more advanced and 'real' restructuring proceedings are available in the Luxembourg legislation, the question arises whether the market attractiveness of the Double Luxco will be affected.

Notes

1 The views expressed in this article are those of the authors and do not necessarily reflect the views of Loyens & Loeff.
2 The current article is most relevant for Double Luxco structures where Luxembourg pledges or assignments are granted by a Luxembourg security provider. Other considerations need to be taken into account in case of a foreign security granted by a Luxembourg security provider or a Luxembourg security granted by a foreign company.
3 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.
4 Luxembourg financial collateral security (i.e. share, claims (notes, intercompany loans and other types of claims) and account security) is, contrary to other European security interests, bankruptcy remote, cost efficient, easy and fast to enforce (no freezing period and no third party intervention). One of its other advantages is also that security enforcements are difficult to successfully challenge before Luxembourg courts and are sufficiently court tested to preserve much judicial certainty.

B. New restructuring tools *versus* Double Luxco security

1. Restructuring Law – setting the scene

More than a decade after the submission of the initial bill of law[5] to the Luxembourg Parliament, the Luxembourg legislator finally adopted on 19 July 2023 the Restructuring Law which implements the EU Restructuring Directive[6] and modernises the Luxembourg insolvency and restructuring landscape. The aim was to offer a second chance to debtors[7] in financial difficulties, with judicial and non-judicial reorganisation tools to preserve their business and avoid bankruptcy by increasing the attractiveness and competitiveness of the restructuring and insolvency framework.

While it was crystal clear from the recitals[8] of the EU Restructuring Directive and the parliamentary work[9] of the Restructuring Law that an enforcement of a Luxembourg security interest should remain unaffected by the opening of reorganisation procedures, some 'dead angles' and vague wordings in the Restructuring Law gave rise to a certain number of questions and possible interpretation issues among Luxembourg lawyers, notably on whether a secured creditor could still enforce its Luxembourg financial collateral security if such security was triggered by a 'strict' acceleration only and a judicial reorganisation procedure was opened in the meantime.

2. Overview of the new Luxembourg restructuring tools

The Restructuring Law offers new detection[10] and conservatory[11] measures as well as one new out-of-court reorganisation by amicable agreement procedure.[12]

In addition, the Restructuring Law offers one in-court judicial reorganisation procedure for debtors being in financial difficulties. The opening condition of this procedure is very light as the only requirement is that the business of the debtor needs to be jeopardised at short or long term (*mise en péril de l'entreprise à bref délai ou à terme*). One of the first court decisions[13] on the Restructuring Law confirmed that the opening of a judicial reorganisation proceeding is not conditional on the debtor's good faith but that the delegated judge (*juge délégué*) of the court would still look at viable options[14] presented by the debtor to overcome the financial difficulties.

Once the condition is fulfilled, the judgment opening a judicial reorganisation proceeding will order a stay on payments (*sursis*) to allow the debtor to either (i) conclude an amicable agreement with some creditors, (ii) obtain a judicial reorganisation by collective agreement or (iii) obtain a judicial transfer of its assets or activities. The duration of the stay can't exceed 4 months[15] in the first instance[16] and is assessed by the delegated judge on a case-by-case basis by balancing the need to protect the debtor and the rights of its creditors.

It is precisely the combination of the granting of this stay on payments and the wording of article 30 of the Restructuring Law that gave rise to cold sweats among practitioners. Article 30 sets out that ongoing contracts shall continue during a judicial reorganisation proceeding, meaning that no early termination of contracts is permitted. Is this a concern in an enforcement scenario of a Luxembourg pledge where the trigger event for enforcement is exclusively linked to a strict and automatic debt acceleration of the underlying debt?

If a Luxembourg court were to interpret acceleration as being equivalent to the termination of contract (which is unclear to date but a possibility that cannot (yet) be ignored), the enforcement of a pledge based on a strict acceleration could be temporarily delayed.

Notes

5 Bill of law no. 6539 submitted on 1 February 2013 and subsequently divided on 22 July 2021 into bill of law no. 6539A on business preservation and modernisation of bankruptcy and bill of law no. 6539B on the creation of administrative dissolution without liquidation procedure.

6 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

7 Including, without being limited to, natural persons qualifying as traders and commercial companies within the meaning of the Luxembourg Commercial Code.

8 Recital 94 of the EU Restructuring Directive 'The stability of financial markets relies heavily on financial collateral arrangements (...). As the value of financial instruments given as collateral security may be very volatile, it is crucial to realise their value quickly before it goes down. Therefore, the provisions of Directives 98/26/EC (19) and 2002/47/EC (20) of the European Parliament and of the Council and Regulation (EU) No 648/2012 should apply notwithstanding the provisions of this Directive. (...)'.

9 Notably in the opinions provided by the Luxembourg Council of State on 1 December 2015 (parliamentary document no. 6539/07, pages 2, 13, 14, 18 and 32) and 20 December 2019 (parliamentary work 6539/15, pages 4 and 11) and by the Council Bar of the Luxembourg Bar on 8 August 2013 (parliamentary work 6539/03, page 2) and 14 June 2023 (parliamentary work 6539A/05, pages 12 and 13).

10 New duties for the Minister for the Economy and Minister for Small and Medium-Sized Enterprises to detect companies in financial difficulties.

11 Creation of an assessment unit to assess the suitability of bankruptcy proceedings by representatives of public entities or administrations.

12 Article 11 of the Restructuring Law.

13 Luxembourg District Court, 22 November 2023, TAL-2023-09252.

14 Luxembourg District Court, 15 December 2023, TAL-2023-09434.

15 Article 20(2) of the Restructuring Law.

16 Article 33 of the Restructuring Law offers one or more extensions the total of which cannot exceed 12 months.

Would this be in line with the spirit of the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (the 'Financial Collateral Law') which implemented the Financial Collateral Directive?

3. Financial Collateral Law – still indisputable?

One key advantage of the Financial Collateral Law is that an asset over which a security interest has been granted in favour of a secured creditor does not form part of the bankruptcy estate (*hors de la masse de la faillite*)[17] of the pledgor. This very favourable creditor-friendly provision also disregards claw-back and other applicable bankruptcy provisions.[18]

The Financial Collateral Law[19] ensures hence a very high degree of bankruptcy remoteness[20] and enforceability[21] notably to (i) financial collateral arrangements, (ii) netting agreements and (iii) waivers of rights of national or foreign provisions governing bankruptcy, insolvency, reorganisation measures or other similar proceedings and attachments which has been qualified by Luxembourg courts[22] as being an overriding mandatory provision.

This principle has been recently reinforced further to the amendments done to the definition of 'winding-up proceedings' in the Financial Collateral Law which has been extended to cover judicial reorganisation proceedings. Luxembourg courts[23] also confirmed several times that a Luxembourg pledge falling within the scope of the Financial Collateral Law remains fully enforceable in accordance with its agreed terms notwithstanding the attempt by debtors to challenge this by opening foreign insolvency proceedings.

So, what is the concern? The protective measures of the Financial Collateral Law do not apply to the underlying debt documents and in the (rare) case that the trigger event for enforcement in a Luxembourg pledge is solely linked to a 'strict acceleration' of the underlying debt, there may be uncertainties as to the question whether a stay would temporarily prevent secured creditors from enforcing the pledge in case a judicial reorganisation proceeding is opened by the debtor in Luxembourg.

Even if this scenario is highly theoretical and requires a combination of actions, it is not surprising that many are hoping for the possibility to challenge the well-established and rock-solid practice around financial collateral arrangements and Double Luxco structures because of how valuable these are for secured creditors to mitigate insolvency risks and centre of main interests relocation (also known as 'COMI shift') of debtors in acquisition finance deals across Europe.

There are good arguments (in addition to the spirit of the EU Restructuring Directive and the parliamentary works of the Financial Collateral Law) to mitigate any potential risk for secured creditors in a scenario where the trigger event for enforcement would be exclusively linked to a proper acceleration of the underlying debt:

(a) an acceleration is not required under Luxembourg law to trigger a security enforcement and the Financial Collateral Law offers full contractual freedom without any limitation in the determination of the trigger event(s) for enforcement.[24] As such, a payment default is not required and other events such as non-compliance with financial ratios or any other contractually agreed event(s) may trigger an enforcement. In practice, often the underlying debt documents will include other trigger events to allow the secured creditor to enforce the pledged assets or the definition of acceleration event will not necessarily be limited to a 'strict acceleration', i.e. an automatic or obligatory action rending the secured debt immediately due and payable (as opposed to, for instance, allowing a payment on demand or similar non-strict acceleration mechanics).

(b) even if not excluded by the Restructuring Law, it remains to be seen in practice if the judicial reorganisation proceeding applies to special purpose vehicles which are commonly used in Double Luxco structures as some provisions of the Restructuring Law seem to apply more to operational companies.[25] A recent Luxembourg judgment[26]

Notes

17 A. Cloquet, *Les Novelles, droit commercial*, Tome IV, *Les concordats et la faillite*, 3rd edn, 1985, pp. 530, 581.
18 The Financial Collateral Law is wider in its effects compared to article 8 of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).
19 Article 20(4) of the Financial Collateral Law.
20 Other than for natural persons under applicable law over indebtedness.
21 Except under the general principle of fraud (*actio pauliana*).
22 Luxembourg District Court, 14 October 2010, 3367603, Luxembourg Court of Appeal (*référé*), 3 November 2010, 35824, Luxembourg District Court (*référé*), 15 July 2015, 169707, Luxembourg District Court, 1 August 2016, 41324, Luxembourg District Court, 23 December 2016, 168216, Luxembourg District Court, 5 June 2020, TAL-2020-01846.
23 For example, Luxembourg District Court 29 January 2014, 153635 and 153 636 and Luxembourg District Court, 24 May 2017, 175090.
24 The definition of 'enforcement event' in the Financial Collateral Law has been amended on 20 July 2022 and now expressly refers to an event of default or any other event whatsoever (underlined) as agreed between the parties.
25 It may also be interesting to note that as at 20 February 2024, four judicial reorganisation proceedings have been opened since the entry into force of the Restructuring Law, all of which relate to operational companies.
26 Luxembourg District Court, 18 December 2023, TAL-2023-09111.

confirmed that a judicial reorganisation by way of a court transfer of all or part of the debtor's assets or activities does not apply to special purpose vehicles so it remains to be seen whether this position of the court will hold and extend further.

Conclusion

Even if the Restructuring Law has deeply changed and modernised the Luxembourg restructuring framework, the use and success of the new restructuring tools remain to be seen in practice and should not affect the success of the Double Luxco structures.

The Luxembourg legislator has clearly set the Double Luxco related security interests as being outside of the scope of the Restructuring Law. There could be a friction which would be based on the potential stay of the (usually foreign) trigger event as opposed to a stay on the enforcement itself, but this set up is rather rare. In order to have a real friction between the Double Luxco and the Restructuring Law, one would need to have (i) a trigger event that is limited to an automatic or strict acceleration of the debt and (ii) the courts having ruled that an acceleration is equivalent to a termination of the underlying debt documents.

Luxembourg legal professionals are currently in agreement that the risk is extremely limited and can also easily be solved in practice by slightly widening the trigger event of the Luxembourg security if such trigger event is limited to a 'strict acceleration'. Even if such risk were to materialise, it would still make Luxembourg financial collateral security much more creditor friendly than the security in other European jurisdictions.

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