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# Insolvency proceedings: what are the options?

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Introduction



## Introduction

On 16 January 2021 the Supreme Court reconfirmed that a liquidated company is deemed to survive passively for five years further to the publication of the closure of the liquidation in the Luxembourg Trade and Companies Register. This allows the company's creditors to introduce a legal action against it.

Further, the Supreme Court stressed that the general meeting of a liquidated company is also deemed to survive during this period (or for longer) if a legal action is introduced against the company during the five-year period.

## Filing for insolvency is not optional

In the current COVID-19 context, which is putting many economic actors out of business and preventing some from meeting their payment obligations, this decision highlights that a liquidation does not enable companies to bypass paying creditors.

A company that can neither pay its debts nor obtain credit to do so must, in principle, file for insolvency within one month of the due date of its debts. Failure to do so might entail serious consequences, such as the personal liability of the company's management or criminal penalties.

In order to protect creditors from being defrauded by an unlawful liquidation, the legislature and case law have implemented several safeguards, such as:

- the aforementioned passive five-year survival;
- the possibility to initiate insolvency proceedings against a liquidated company (within six months of the closure of the liquidation); and
- the possibility to claim damages from the liquidator.

The legislature has exceptionally extended the above deadline by suspending the obligation to file for insolvency until 30 June 2021 (although it remains possible to file for insolvency before then).

## Debt restructuring followed by liquidation as an alternative

This extension buys unviable businesses additional time to negotiate a debt reduction or waiver with their creditors. If all of the creditors consent, the business can be wound up by a standard voluntary liquidation in lieu of an insolvency.

A voluntary liquidation can be undertaken privately and rapidly and remains under the complete control of the company's shareholders, which remain free to appoint the liquidator that they choose (as opposed to an insolvency receiver, which is appointed upon the sole discretion of the District Court).

Creditors will be reimbursed faster (insolvencies have a mandatory minimum duration of six months) and no insolvency receiver fees (or other costs incurred due to an insolvency) will be deducted from their reimbursements.

Most importantly, voluntary liquidations do not involve public authorities (the Luxembourg public prosecutor must be informed of all insolvencies) or the publicity, stigma or potential reputational damage of an insolvency.

Insolvencies may trigger a notification obligation on behalf of the managers or directors of the insolvent company to the Luxembourg financial regulator if they are members of the board of a regulated entity and it could prevent them from applying for a business licence in the future (as opposed to a voluntary liquidation, which does not bear any of these consequences).

Further, in contrast to a liquidator, an insolvency receiver has a dual mission; it represents not only the insolvent company but also its creditors. As a consequence, the insolvency receiver may introduce legal actions against the former managers or directors of the insolvent company to hold them liable for the insolvent company's liabilities if serious mismanagement can be demonstrated and insufficient funds are available to settle all of the debts.

A voluntary liquidation, if accepted by all creditors, might thus constitute the best option for all parties involved.

**Points of attention and key differences between insolvencies and liquidations**

The potential tax implications of debt reductions or waivers must be considered when pondering the option of a debt restructuring followed by a voluntary liquidation, since they could give rise to tax liabilities.

Further, liquidations bear certain key differences compared with insolvencies.

A liquidation does not stay enforcement measures against the liquidated company (eg, attachments which remain possible in case of a liquidation), whereas an insolvency stays every enforcement measure (except for security interest governed by a specific law, such as the Financial Collateral Law) as of the day on which the insolvency judgment is rendered. As a consequence of an insolvency, creditors must lodge their claims with the District Court, further to which they will be examined by the insolvency receiver and accepted or rejected.

A liquidation is, in principle, final and irreversible (even if funds should reappear), whereas an insolvency can be reversed once all of the debts are settled (either through an appeal or third-party proceedings), provided that the relevant limitation period has not yet lapsed.

**Comment**

The Luxembourg legal framework applicable to insolvencies has not changed due to COVID-19, except for the extension of the insolvency filing deadline until 30 June 2021.

Any business that is meeting the insolvency criteria must file for insolvency unless its creditors agree to a debt restructuring. In that case, the voluntary liquidation becomes an option worth considering for winding up a business.(1)

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**Endnotes**

(1) Luxembourg law does not provide any specific out-of-court debt restructuring rules other than certain outdated and impractical alternative recovery procedures that are rarely used and have not been analysed in this article.