Procedural tactics in Luxembourg corporate and financial disputes: noteholders' relief

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Notes ("obligations") are negotiable instruments of a collective character conferring creditor rights to their holders ("obligataires")[1] to the benefit of both the issuer (enabling it to rapidly secure funds) and noteholders (who receive guaranteed interest payments during the life of the notes alongside the repayment of the principal at the maturity date).[2]

Raising funds by way of issuing notes or bonds has become very popular in Luxembourg amongst companies of all sizes, whether public or private, irrespective of their corporate form. Since 2016, all commercial companies may issue notes,[3] but the collective character of the debt renders them more appropriate for companies seeking large amounts of funding.[4] Provisions applicable by default to the issuance of notes are provided in the Law on Commercial Companies of 10 August 1915 ("**LCC**"). However, these can be amended, derogated from and fully excluded depending on the articles of association and the issuance documentation.[5] Issuers may also subject the documentation to foreign law.

Rights, organization and representation of noteholders

Noteholders are creditors of the company. They are entitled to the reimbursement of the amounts loaned to the company as well as interests, at the due date. The interest rate payable to the creditor is an essential part of the contractual documentation which reflects the financial standing of the issuer, market conditions, inflation rates and the risks taken by noteholders.[6] Interests are typically payable on a yearly, semi-annually or quarterly basis. Payment does not depend upon the availability of distributable assets and remains due according to the terms of the issuance documentation irrespective of the issuer's financial performance, except in the event of bankruptcy.[7] Noteholders have a right to equal treatment within the same class (*masse*), but the issuer may grant different rights (e.g. different interest rates, maturity dates, early repayment conditions, etc.) to different classes.[8]

Since the loan to the company is often long-term, the noteholders are tied to the fate of the issuer over a long period. For this reason, the Luxembourg legislator granted noteholders certain information rights over the corporate activity and provided for the organization of a class (*masse*) to allow their opinion to be heard.[9] Noteholders however enjoy much more limited information rights than shareholders and do not have large powers to inspect the company's affairs. The provisions of the LCC (if applicable) allow them to take knowledge of the documents available to shareholders before the annual meetings (including accounts, management and auditor's reports). Noteholders may attend general meetings, provide comments and ask questions, but they have no voting rights.[10] As creditors, noteholders do not enjoy the right to consult the shareholders' register, which is established for the benefit of the company and of its shareholders only.[11]

Subscribers of a company's notes forming part of the same issue are organized in a class (*masse*), which does not own assets of its own and does not possess a separate legal personality. A class is created for each issue of notes[12] and all members of this class meet in general meetings that bind the members by a majority vote.[13] The creation of a class is intended to facilitate communication and decision-making in the issuer's interest, while also benefiting noteholders.[14] For example, if the issuer is facing financial difficulties, the noteholders' majority vote may allow to quickly restructure the conditions of the issuer's debt (e.g. reduce the interest rate, amend the conditions of repayment, extend the maturity date, etc.)[15] and may thus prevent a bankruptcy filing. The functioning of noteholders meetings is largely inspired by the rules applicable to shareholders' meetings of public limited companies.[16]

When the provisions of the LCC are applicable, these provide that each class of noteholders is represented by one or more representatives, who may be appointed either at the moment of issuance of the notes by the competent organ of the company,[17] or during the lifetime of the notes by general meeting of noteholders. In this case, the general meeting of the class decides freely on the representatives' powers and mandate, duration of appointment and remuneration.[18] Their liability is assessed in the same way as that of an employee representative or agent.[19] When representatives have not been appointed at the time of the issuance of the notes, or later on by general meeting, the LCC (if applicable) expressly allows any interested party (e.g. the issuer itself, a noteholder or in principle any interested third party), in case of urgency, to petition the District Court sitting in commercial matters and as in summary proceedings (*comme en matière de référé*), to request the appointment of a class representative with specific powers.[20] The President of the District Court shall decide following the usual form and speed of summary proceedings, which may take as little as a few weeks. Representatives may be revoked by general meeting of the class, or by the tribunal.

For the most part, noteholders' decision making power is transferred to these representatives. Their powers generally include the power to convene meetings,[21] to take conservatory measures to protect the noteholders' rights and interests within their class[22] and to perform certain management acts on behalf of the noteholders.[23] Class representatives may also represent and act in the interests of noteholders in legal proceedings, but only to enforce the resolutions taken by the general meeting of noteholders (and not to enforce noteholders' individual rights). This is practical from a procedural standpoint since all noteholders would otherwise need to be joined to the proceedings.[24]

Irrespective of the appointment of a class representative, noteholders retain certain individual rights, such as the right to the reimbursement of the principal and of the payment of interests at the due date(s). When the company is in default and fails to pay the amounts due, a noteholder may seek to terminate the agreement (*résolution*) and/or seek damages, or force the payment by initiating proceedings.[25]

In this case, the claimant would be the individual noteholder, but in principle nothing would prevent several noteholders from initiating proceedings as co-claimants against the same issuer to increase the size of the claim and their bargaining power. While it is often strategically beneficial to join forces to file a claim, claimants shall assess the jurisdiction of the tribunal carefully, as the claims (if considered separately) may fall under the jurisdiction of different courts depending on the amounts sought. To overcome this hurdle, claimants may argue the existence of a common title (*titre commun*) and/or the strong connexity of the claims (e.g. same issuance documentation, same cause of action, risk of conflicting decisions, etc.), to justify bringing them before the same court.

When the relationship takes a contentious turn with the issuer, all legal fees incurred by the issuer (e.g. responding to formal notices, establishing a defense strategy, defending against legal proceedings, etc.) would be drawn from the issuer's funds and may reduce the amounts ultimately available for payments to noteholders. Creditors also want to consider the risk that – if faced with a large claim – the issuer may file for voluntary bankruptcy leaving the creditors no alternative but to file a proof of claim and hope that the appointed trustee will realize sufficient assets to reimburse the amounts due.[26]

An additional hurdle faced by international creditors is to become aware in due time of the bankruptcy filing and of the issuance of a bankruptcy judgment, as they are under a strict 6-month deadline to file their proof of claim. While a recourse is available to extend this 6-month period, a claimant will have to demonstrate that it was objectively prevented from becoming aware of the bankruptcy and its absence of fault and negligence. This threshold is hard to meet if the publication requirements in the national journals (Wort and Tageblatt) are met, and since the information of the bankruptcy is available online on the Register of Commercial Companies. The class of noteholders does not cease to exist when the issuer is declared bankrupt.

The judicial appointment of a noteholders' representative (article 66 NCPC)

Difficulties may arise when noteholders need to appoint a class representative to enforce their rights against a bad faith issuer but cannot petition the President of the District Court pursuant to article 470-4 LCC, because the provisions of the LCC were excluded. In this case, noteholders need to rely on the terms of the issuance documentation to seek to convene a general meeting and pass the necessary resolutions, which may allow a recalcitrant issuer to create various obstacles to materially prevent the organization of a general meeting.

The terms and conditions may provide that noteholders – holding a certain percentage in nominal amount of the notes outstanding – can request the issuer to convene a general meeting, but the issuer may contest or be unresponsive. The contractual documentation may allow noteholders to convene the general meeting requiring the involvement of service providers,[27] but their agreements may be terminated.

In such cases, the need may arise to formally appoint a class representative without delay to initiate legal proceedings, in Luxembourg or abroad, to preserve the noteholders' rights. Any interested party (most often a noteholder or an asset manager representing the interests of its investors) may consider initiating an action based on article 66 of the Nouveau code de procédure civile ("**NCPC**") to request its own appointment as class representative and initiate proceedings on behalf of the class.

Article 66 NCPC[28] provides an exceptional recourse in civil procedure in that it allows a requesting party to ask the court to render a unilateral measure (*ex parte*), which is to say not further to an adversarial debate, either when the law expressly allows for it or when the necessity dictates. With respect to the appointment of a class representative, since the law does not expressly allow a unilateral measure, the requesting party shall demonstrate a very clear case of necessity. This criteria is met either when it is necessary to create an element of surprise, when it is impossible to identify with certainty and precision the persons against whom the measures are to be carried out, or in cases of urgency.[29] The courts will make a narrow interpretation of these conditions, given the unilateral and exceptional nature of the procedure. The case law is clear that urgency must be linked to the risk of serious and imminent harm requiring an immediate measure which cannot suffer from the delay caused by recourse to an adversarial procedure.[30] In other words, urgency amounts to a necessity which suffers no delay.

In the hypothetical scenario considered above, the requesting party may argue that it is objectively prevented from holding a general meeting to appoint a class representative, and present clear and convincing evidence of the harm suffered by the noteholders if the unilateral measure is not granted expeditiously (the urgency being assessed on the day of the request). The requesting party may demonstrate that the immediate need for the measure (usually rendered within a few days) renders inappropriate another recourse, including summary proceedings (leading to a decision within a few months).

The court will likely not grant the measure based on article 66 NCPC if the summary proceedings do not offer an efficient recourse by reason of a delay caused by the requesting party.[31] Further, if the appointment is imperative to initiate proceedings, the requesting party may be expected to prove, on the basis of the supporting documentation, that it is an issue of standing and admissibility of the claim based on objective necessity, rather than an issue of personal convenience to the noteholders (which would likely not justify doing away with an adversarial debate).

In any event in these proceedings, as is the case when any unilateral measure is sought from the court, the requesting party is under a reinforced obligation of loyalty to bring forward complete and sincere information to the judge.[32] A negative outcome would not damage the requesting party's interests as the decision would not be notified to the person against whom the measure is sought. The requesting party may file an appeal before the Court of Appeal within 40 days. In case of a positive outcome, the Luxembourg legislator provided that the person against whom the measure is carried out may exercise a retractation recourse against it, within no specific timeframe.

Recourse against the issuer's debtors: the indirect legal action (action oblique)

In principle, under Luxembourg law, contracts only create rights and obligations between the contracting parties and do not prejudice or benefit third parties.[33] Thus, noteholders have no direct right of action against any debtor of the issuer to enforce their rights under the notes, or to compel any debtor to comply with its obligations, irrespective of the issuer's failure to act. However, creditors may take certain steps on behalf of their debtor to recover amounts due to it.

Article 1166 of the Luxembourg civil code provides that creditors may, under certain conditions, exercise the rights of their negligent debtors against their own debtors by way of an indirect legal action (*action oblique*). The issuance documentation may expressly confirm the right of noteholders to initiate such indirect legal action on behalf of the issuer and provide certain conditions of application.

Luxembourg case law identified the following criteria to succeed in an indirect legal action:[34] (i) the moving party must have a monetary claim which is certain, liquid and due against its debtor (the majority view is that the value of the claim must be purely monetary);[35] (ii) it must have a serious and legitimate interest in bringing its debtor's claim forward, (iii) it must demonstrate that its debtor fails to act against its own debtor(s) and that this failure is likely to endanger its rights and jeopardize its claim against its debtor (the issuer's failure must be complete, as inappropriate action by the issuer such as initiating proceedings before the wrong court or on the wrong grounds, would likely create an obstacle to the indirect action), (iv) it must have the obligation to act in order to preserve its interests as a matter of emergency, and (v) the rights exercised by the moving party cannot be personally attached to the person of the debtor.

By exercising an indirect legal action, a noteholder steps in the shoes of the negligent issuer and initiates proceedings seeking to reconstitute and increase the size of the issuer's estate. The creditor initiating this action has no preferential right over its outcome: any amounts recovered would not allow payment of the moving party directly, but rather return to the negligent debtor, so as to enable the noteholders to exercise their means of enforcement against the issuer's assets.(36) If its powers and mandate allow for it, it may be appropriate for a class representative to initiate these proceedings since the indirect legal action benefits all creditors of the issuer.

1) CORNU G., *Vocabulaire juridique*, 13th ed., 2016, PUF, p. 710
2) MERLE, P., *Droit commercial. Sociétés commerciales*, 2024, Dalloz, p. 448
3) Article 100-14 LCC.
4) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 390.
5) Article 100-14 LCC
6) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 397, para. 512
7) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 397-398.
8) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 397-398.
9) J.P. WINANDY, Manuel de droit des sociétés, 2019, p. 551.
10) Article 470-2 LCC.
11) J.P. WINANDY, Manuel de droit des sociétés, 2019, p. 504.
12) Article 470-2 LCC.
13) Article 470-10 LCC.
14) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 399.
15) Article 470-13(5) et (6) LCC.
16) For example regarding convening ordinary or extraordinary general meetings, agendas, resolutions, etc., Article 470-11 LCC ; STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 400.
17) Their powers are defined by law and listed at article 470-5 LCC.
18) Article 470-4 LCC.
19) Article 470-7 LCC.
20) Article 470-4(2) LCC.
21) Article 470-9 LCC.
22) Article 470-5(1)(3) LCC.
23) Such as accepting the collateral to secure the company's debt, granting the release of mortgage inscriptions, supervising the execution of the amortization plans and payment of interest, representing noteholders in bankruptcy and related proceedings, etc., Article 470-13(4) LCC.
24) Article 470-5(1)(6) LCC.
25) STEICHEN, A., *Précis de droit des sociétés*, 6th ed., 2018, p. 399.
26) In accordance with article 437 of the Luxembourg Commercial Code, a commercial entity is bankrupt when (i) it has ceased its payments (*cessation des paiements*) and (ii) its credit is exhausted (*ébranlement du crédit*). The failure to pay a single undisputed, certain, liquid and due debt is in principle sufficient to satisfy the first criteria, and courts often tie the loss of creditworthiness to the debtor's cessation of payments (since one's failure to pay its debts as they become due would logically not inspire trust in equity, debt or commercial partners). See also A-M. Nicolas, O. Marquais, *Common struggles faced by international creditors in Luxembourg bankruptcy proceedings*, International Insolvency & Restructuring Report 2021/22, available at: https://lc.cx/h5oYm4
27) For example a paying agent may need to issue voting and blocking certificates allowing the noteholders to participate and vote.
28) Article 66 NCPC provides that "*where the law permits or necessity dictates that a measure be ordered without the knowledge of a party, this party shall have an appropriate remedy against the decision which adversely affects it.*"
29) T. Hoscheit, *Le droit judiciaire privé au Grand Duché de Luxembourg*, 2e ed, Paul Bauler 2019, no. 1493 page 786.
30) CA, 8 December 2021 ; CA, 16 february 2022, no CAL-2022-00150.
31) CA, 17 avril 2023.
32) TAL (réf.), 22 may 2020, TAL-2020-03229 du rôle.
33) Article 1165 of the Luxembourg civil code.
34) CA, 8 mai 2019, Pas. 39, p. 536; Cass. 14 janvier 2021, N. 03/2021.
35) This is logical since this action seeks to increase the size of the debtor's estate. However, it may be argued that claims which are not purely monetary may be pursued if they have, as a direct consequence, to allow assets of monetary value to enter into the debtor's estate for the benefit of creditors.
36) TAL, 22 janvier 2020, 15/00097.