

Directors' Accountability and Insolvency: Luxembourg's Response Towards Wrongful and Fraudulent Trading, and Mismanagement in Insolvency Procedures

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Directors' duties and liabilities have become major issues since the wave of financial scandals and, especially, corporate bankruptcies among major companies such as Enron, Ahold, Parmalat and Worldcom. As a result, the European Union was eager to provide an appropriate regulatory response, notably through the adoption of an action plan on May 21, 2003 by the European Commission to modernise company law and enhance corporate governance.

While facilitating the establishment of companies and granting freedom in their governance, the plan also aims to strengthen directors' duties and liabilities with regard to financial and key non-financial statements and wrongful trading by way of a ban on trading and directors' disqualification across the EU territory. It also indicates that EU countries tend to apply varied sets of rules regarding wrongful trading and fraudulent trading, and more generally directors' duties and liabilities upon insolvency.

With regard to Luxembourg in this respect, as a first step the country has adopted a new law dated August 25, 2006 concerning the European company, the public company limited by shares (*société anonyme*) having a management board and a supervisory board and the sole shareholder public limited company (*société anonyme unipersonnelle*). This law introduces the possibility and the choice for a public company limited by shares

to be governed by a management board (*directoire*) under the supervision of the supervisory board (*conseil de surveillance*) rather than by the classic board of directors. At this stage, it would appear that the traditional board of directors retains the favour of the market, as very few public companies limited by shares would take the option to be governed by a management board.

One other highly important innovation of this law is the obligation for a company acting as a director or as a member of the management board to appoint a permanent individual representative who will incur the same liability as he would if acting personally and in his own name. This considerably reinforces the rights of shareholders and third parties, as companies under Luxembourg law do not incur criminal liability or criminal sanctions, which is obviously not the case for individuals.

Such changes reinforce Luxembourg's intention to secure third parties' and shareholders' interests and ensure flexibility in the choice of governance. Importantly, a new Bill deposited on June 8, 2007 confirmed the desire for Luxembourg to implement the European Commission's Action Plan. In particular, this Bill intends to introduce the possibility for the board of directors to delegate its powers to an executive committee (*comité de direction*) and to reinforce the directors' liability and the rights of minority shareholders.

This article provides a broad summary of the duties and liabilities of public limited liability company directors and members of the management board for their corporate activities during the normal life of their public limited liability company, including when the company is threatened by insolvency or becomes insolvent.

First, it is important to consider those concepts which lead to wrongful or fraudulent trading, and the business judgment rules that run parallel with the aforesaid concepts under Luxembourg law. It is also important to look at whether Luxembourg shows a "pro-creditor" or "pro-business" attitude through the scope of Luxembourg law on commercial companies dated August 10, 1915 as modified (the Company Law) and insolvency law rules related to directors and members of the management board's duties and liabilities upon insolvency.

Corporate activities and powers of the board of directors and of the management board

The board of directors and the management board are entitled to take any action deemed necessary to realise the corporate object of the company, except for the powers that are expressly reserved by law or by the company articles to the general shareholders' meeting and to the

supervisory board when the corporate governance of the company is entrusted to the management board.¹ It is therefore clear that apart from the powers expressly reserved by the Company Law to the shareholders in a general meeting or to the management board, management power lies either with the board of directors or with the management board.

Overview of general liability of directors and members of the management board

Civil liability

When exercising their respective mandates, directors and members of the management board must act with the standard of care and diligence that a reasonable director would exercise. This duty is respectively imposed on the directors and on the members of the management board by virtue of para.1 of art.59 and para.1 of art.60bis-10 of the Company Law,² which sets forth an individual contractual liability rule. Directors and members of the management board may also be held individually liable in tort for breach of such standards of care and diligence according to arts 1382 and 1383 of the Civil Code. In addition, para.2 of art.59 for directors and para.2 of art.60bis-10 of the Company Law for members of the management board set forth joint and several liabilities towards the company and third parties for breach of the law and/or of the articles of association.³

The provisions in the Company Law dealing with the liability of directors and that of the members of the management board are exactly the same and both incur the same liability.

Individual liability—liability under contract

As would be expected, given that directors or members of the management board are considered

to be agents of a company, they can be held liable for breach of their mandate⁴ towards the company (*actio mandati*). And, as a result of the personal nature of a mandate, they could be sued individually for any breach of their contractual liability.⁵ Contractual liability under Luxembourg law is subject to evidence of three cumulative elements: the commitment of a fault, damages suffered and a causal link between the fault and the damages.

In terms of fault, directors and members of the management board are liable for all their acts or omissions. The fault could range from simple negligence to an act punishable by the criminal court, but it always remains a contractual breach. It will be assessed at the time of the wrongful misconduct and in accordance with the standard of care expected of a reasonable director or member of the management board, which in turn is not based on infallibility. The courts will assess the acts or omission in the context and at the time they were adopted. It is only where such acts or omission are seen to be unreasonable under the circumstances that a director or a member of the management board shall be found in breach of the reasonable standard of care. Determining reasonableness is a question of fact submitted to the appraisal of the court.

This action can be taken within five years after the action taken by directors or members of the management board in that capacity, or, if these actions were fraudulently concealed, five years after the discovery of the fraud.⁶

Tort liability

A violation of a director's or of a member of a management board's mandate or misconduct in the management of a company could also cause damage to third parties. In such a case, the director or the member of the management board may find themselves liable in tort.⁷ In order to bring liability proceedings on this basis, a fault, damage and a causal link between the two must be proven. The fault shall consist of a breach of the standard of care expected from a reasonable director or member of a management board.

1. Company Law arts 53 para.1 and 60bis-7.

2. "The directors/members of the board management shall be liable to the company, in accordance with the *general law*, for the execution of the mandate given to them and for any misconduct in the management of the company's affairs."

The reference to the "general law" indicates that the directors' liability based on this paragraph is personal and individual, unless there is evidence that the prejudice suffered is causally linked with a wrongful act of each director (*in solidum* liability).

3. "They shall be jointly and severally liable both towards the company and any third parties for damages resulting from the violation of this law or the articles of the company. They shall be discharged from such liability in the case of a violation to which they were not a party provided no misconduct is attributable to them and they have reported such violation to the first general meeting after then had acquired knowledge thereof."

4. Similar to the fiduciary duty, they have a duty to act with the highest degree of honesty and loyalty, and in the best interests of the company.

5. Company Law art.59 para.1.

6. Company Law art.157.

7. Luxembourg Civil Code art.1382 states that:

"any act by which a person causes damage to another makes the person through whose fault the damage occurred liable to repair such damage."

Article 1383 continues:

"Anyone who causes damage which he causes not only by his own act but also by his negligence or carelessness is liable for the damage that he causes."

Even though the “business judgment rule”⁸ gives less protection to directors in Luxembourg than in common law countries, case law continues to protect and promote the full and free exercise of a director’s managerial power. Liability in tort applies up to 30 years after the punishable act.⁹

Directors’ and members of a management board’s joint and several liability in cases of breach of the law or of the articles of association

In addition, the directors and the members of the management board will be liable under contract towards the company or in tort towards third parties, jointly and severally for damages resulting from the violation of the Company Law or of the articles of association.¹⁰ There is a presumption of joint liability with respect to damages resulting from the violation of the Law or of the articles of association. Directors or members of the management board can, however, be exempt from the liability of such collegiate decision-making. In these circumstances, they must demonstrate that no misconduct is attributable to them and that they reported such violation to the first general meeting after they had acquired knowledge thereof. The time limit for prescription is the same as with liability under contract, namely five years.

At this point, it is important to highlight that the Bill of June 8, 2007 intends to extend the joint and several liability of directors and members of a management board where there is breach of the law governing accountancy rules.

Directors’ and members of a management board’s joint and several liability with respect to the corporate capital subscription

The members of the board of directors or of the management board shall be jointly and severally subject to the obligations of the founders¹¹ who are

themselves jointly and severally liable towards all interested parties, notwithstanding any provision to the contrary for:

- any portion of the capital which will not have been validly subscribed for, and any outstanding balance between the minimum necessary capital and the amount subscribed for; they shall *ipso jure* be deemed to be subscribers thereof;
- the full and complete payment of one-fourth of the shares subscribed for, and the payment within a period of five years of the shares issued against contributions other than cash; they shall likewise be under a joint and several obligation for the full and complete payment of the portion of the capital of which they are deemed to be subscribers pursuant to the foregoing paragraph;
- the indemnification of the damage which is the immediate and direct result of either the avoidance of the company or the omission or incorrectness in the instrument or draft instrument of the company or in the subscription forms of the statements prescribed by the Company Law.¹²

Right to sue

The company has the right to sue on a contractual basis (art.59 para.1 and art.60*bis*-10 para.1 of the Company Law) while third parties and especially creditors may do so on a tort basis (art.1382 of the Civil Code). Both the company and third parties are entitled to sue for damages resulting from a breach of the law and/or the articles of association (art.59 para.2 and art.60*bis*-10 para.2 of the Company Law).

Where damage to a company has been proven, liability proceedings will be brought against the directors or the members of the management board by the general shareholders’ meeting and such action will exclude an individual shareholder’s action. If, however, only one or several shareholders can prove personal and distinct prejudice¹³ from the prejudice suffered by the company, they do have the right to

8. Terminology commonly used and especially by Philip R Wood in his book *Principles of International Insolvency*, 2nd edn (London: Sweet & Maxwell, 2007).

9. Luxembourg Civil Code art.2262.

10. Company Law art.59 para.2 for the directors and art.60*bis*-10 para.2 for the members of the management board.

11. Company Law art.32-1 para.2:
“The members of the board of directors or the management board, as the case may be, shall be jointly and severally subject to the obligations of the founders under Article 31.”

Company Law art.28:
“The company may be constituted by means of one or more notarial instruments to which all the members are parties, either in person or by representative(s) holding notarised or private proxies.

The parties to those instruments shall be deemed to be the founders of the company. However, if the instruments designate as founder(s) one or more shareholders who together hold at least one third of the capital of the company the other parties who merely subscribe for shares in cash and are not granted, directly or indirectly, any special advantage shall be regarded as mere subscribers.

If the payments have been made in application of Article 26 before the execution of any of the constitutive instruments, the proof thereof may be furnished in the form of a private receipt, to be drawn up in duplicate.”

12. Company Law art.31.

13. Tribunal d’arrondissement de Luxembourg, dated October 11, 2000.

request reparations. There is currently no action open to minority shareholders on behalf of the company under Luxembourg law after the general shareholders' meeting has granted discharge to the directors or to the management board. Such discharge is only valid if it has been given during the annual general shareholders' meeting after adoption of the annual accounts and only if the annual accounts contains no omission or false information concealing the true situation of the company.¹⁴

This situation may change, however, as the Bill dated June 8, 2007 intends to grant to minority shareholders (who held shares representing at least one per cent of the total voting rights during the general meeting deciding to discharge the directors or members of the management board for their mandate and who have not voted or who voted against such discharge) the right to launch a proceeding against those directors or members of the management board.

The Bill takes it one step further. It allows those shareholders without voting rights to launch a proceeding against the directors or members of the management board in relation to the decisions they took, and for which specific provisions of the Company Law grant them either specific rights or voting rights concerning certain decisions.¹⁵ To reinforce minority shareholders' rights and

interests further, the Bill also proposes to allow those minority shareholders who hold at least 10 per cent of the share capital or of the voting rights of a company to ask questions in writing to the board of directors or to the management board with respect to the management of the company.

Where the board of directors or the management board fails to answer within one month of the request from the shareholders, the latter will be able to request the appointment of an expert by means of an emergency proceeding before the court.

Limited liability provisions and hold-harmless agreements

Directors' liability towards the company and third parties is, according to legal writers, a public policy rule. Contractual restrictions to a director's liability are, therefore, in principle prohibited under Luxembourg law. However, hold-harmless agreements between directors and the company or shareholders of the company are generally not considered as contrary to such public policy rules as they do not hold directors harmless from criminal liability or from liabilities in the event of gross negligence, fraud or wilful misconduct on their part. Also, hold-harmless agreements are restricted to losses, liabilities or other costs incurred in connection with third party claims.

Even though the possibility of entrusting the management of a company to a management board is quite recent, it can be easily assumed that the rules and the principles specified above are applicable to the management board.

Criminal liability

In addition to the civil law liability aspects, s.XI of the Company Law imposes on directors and members of the management board certain criminal penalties in the event of mismanagement or misconduct.¹⁶ Without being exhaustive, two illustrations can be given of such criminal liability penalties.

Directors and members of a management board who do not submit annual accounts to the general meeting within six months after the end of the financial year fail under these provisions. Under these circumstances, not only would the company or third parties have an action against the directors or the members of the management board but the latter would also be criminally liable by virtue of art.163 of the Company Law which foresees a fine of €500 to €25,000 if they are convicted

14. Company Law art.74 para.2.

15. Company Law art.46:

"The holders of shares issued pursuant to Article 44 shall be entitled to vote in every general meeting called upon to deal with the following matters:

- the issue of new shares carrying preferential rights;
- the determination of the preferential cumulative dividend attaching to the non-voting shares;
- the conversion of non-voting preferred shares into ordinary shares;
- the reduction of the capital of the company;
- any change to its corporate object;
- the issue of convertible bonds;
- the dissolution of the company before its term;
- the transformation of the company into a company of another legal form."

Company Law art.44:

- "(1) Non-voting shares representing capital may be issued only on the following conditions:
- 1) they may not represent more than half of the corporate capital;
 - 2) they must, in case of distribution of profits, confer the right to a preferential and cumulative dividend corresponding to a percentage of their nominal value or accounting par value determined by the articles, without prejudice to any right which may be given to them in the distribution of any surplus profits;
 - 3) they must confer a preferential right to the reimbursement of the contribution, without prejudice to any right which may be given to them in the distribution of liquidation proceeds.
- (2) If the condition provided for in 1) is not, or ceases to be, fulfilled, the shares in question shall ipso jure and notwithstanding any provision to the contrary, have the voting rights provided for in Articles 67 and 67-1 without prejudice to the right conferred upon them by Article 46. The same shall apply to any shares to which the rights provided for in 2) and 3) are not, or cease to be, attached."

16. Company Law arts 163 *et seq.*

of being in breach. Only excuses or extenuating circumstances foreseen by the Criminal Code can be used as a defence in these circumstances.

It is not enough for a company to make significant losses in order for a director to be prosecuted; mismanagement must also be demonstrated. Directors and members of the management board who dishonestly use company assets in contradiction of the company's interest are punished under art.171-1 of the Company Law¹⁷ with a fine of €500 to €25,000 and/or imprisonment of one to five years. Criminal liability applies up to three years of the punishable act.

Directors' and members of a management board's liability and companies in financial distress

Although the concept of fraudulent or wrongful trading is not directly implemented in Luxembourg, it is the duty of the board of directors or the management board as applicable to call a shareholders' meeting in cases of serious losses in order to vote on a possible dissolution of the company.

Duty to call a shareholders' meeting

Where losses exceed half or three-quarters of the corporate capital, art.100 of the Company Law places an obligation on the board of directors or the management board of public limited liability companies. They must convene a general meeting which is to be held within a period not exceeding two months from the time at which the loss was or should have been ascertained by the board. Such a meeting will be held to determine the continuation of activity within the company.

If the losses constitute a half of the corporate capital, in order to be adopted the dissolution has to obtain two-thirds of the votes of the shareholders present or represented. Where losses amount to three-quarters of the corporate capital, the dissolution only requires one-quarter of the votes of the shareholders present or represented.

In the event of any infringement of the foregoing provisions, the directors or the members of the

management board may be declared personally, jointly and severally liable vis-à-vis the company for all or part of the loss. This commercial action can be taken up to five years of the time where they should have ascertained the loss.

The Bill of June 8, 2007 intends to modify art.100 of the Company Law by making it mandatory for the board of directors or the management board to draw up a special report containing its positions. This is also the case in scenarios where they propose the continuation of the activity and the measures envisaged to correct the financial situation of the company.

The Bill also places on the board of directors and the management board a presumption of liability. According to the new proposed wording of the article, the damage suffered by the company or third parties in case of default of convocation of the shareholders' meeting is deemed to result from such a default of convocation.

Duty to petition for insolvency

The directors or members of the management board must file a petition for bankruptcy before the clerk's office of the commercial court within one month of the "*cessation des paiements*" (if the company's credit is compromised and if the company has stopped paying its debts).¹⁸ The consequences of omitting to file this petition are described hereafter.

Directors' and members of a management board's liability and insolvency

The actions described above against the directors and members of the management board individually or jointly remain open after a company bankruptcy. However, for those actions belonging to the company and to the creditors, they will be exercised by the trustee in bankruptcy in their lieu. The trustees act in their capacity of representative of either the company or the creditors. After the bankruptcy and within the prescription period, the public prosecutor can also sue the directors and members of the management board in criminal liability. The latter will generally be found liable under contract and/or in tort where they have wrongfully continued the activities of the company while in financial distress, or filed the petition for bankruptcy too late as opposed to the provisions of art.440 of the Luxembourg Commercial Code.

18. Luxembourg Commercial Code art.440.

17. Company Law art.171-1 covers any legally appointed or de facto director who, in bad faith:

"makes use of the assets or the credit of the company which they knew was contrary to its interests, for personal purposes or for the benefit of another company or undertaking in which they were directly or indirectly interested",

or who:

"makes use of the power they had or the votes they could cast, in that capacity, which they knew contrary to its interests, for personal purposes or for the benefit of another company or undertaking in which they were directly or indirectly interested."

In cases of insolvency, the Luxembourg Commercial Code also sets out a particular liability hereafter mentioned in addition to these above-mentioned liabilities from "negligent" to the most "fraudulent" of directors, opened to both the trustee and the public prosecutor. It does not expressly make reference to the members of the management board as it has not yet been modified according to the law dated August 25, 2006. Once again, however, the regime applicable to them must a fortiori be the same as the one applicable to directors.

Extension of the company bankruptcy to the directors and members of the management board

With most bankruptcies, the directors and members of the management board are generally not personally bound by the decisions they make, that is, if these decisions have been taken honestly, in the best interests of the company, and if they have a minimum standard of competence. The company is bound by their decisions even though such decisions might have led to the bankruptcy of the company.

It is nevertheless possible to look beyond the separate entity of the company and its corporate body and hold directors or members of the management board personally liable for their actions. The rationale behind this principle is to prevent fraud. In this respect, the company's debts are merged with those of the director or member of the management board who has acted in their own interest. Article 495 of the Commercial Code envisages this when a director or a member of the management board:

- has undertaken commercial transactions for their own personal interest under the guise of the company. This typically applies to directors and members of the management board who abuse their majority position in the company and direct the company in their own personal interest;
- has used the property of the company as their own property. This concept covers a wide range of different behaviour from typically excessive remuneration, withdrawals from the company's bank account for personal use and performance of renovation or other works by the company for personal ends to payment of personal expenses;
- has improperly continued to work in their own interest with an operating deficit which could only result in the company suspending all of its payments.

Case law¹⁹ on the subject states that they must have acted as a trader (*commerçant*) for a six-month period before the declaration of the company's bankruptcy and that they have (in a personal capacity) ceased to pay the creditors (*ébranlement de crédits*). The director or the member of the management board becomes a trader through the commercial acts of the company. Such an action must be launched within six months from the opening of the bankruptcy in order to avoid the director no longer being considered as a trader.

"Action en comblement de passif"²⁰ (action to bridge insufficient assets)

If there are insufficient assets, the Luxembourg Commercial Court can decide on a motion from the trustee that any shortfall in company assets is made up from the personal assets of the directors or the members of the management board if they have committed a serious and blatant (*caractérisée*) offence leading to the bankruptcy. The court, if requested by the trustee, may demand that the director or the member of the management board (whether appointed or de facto, public or undisclosed, paid or not) to contribute, wholly or partially, jointly or severally, to cover the deficit, under the condition that their serious misconduct has led to the company's bankruptcy.²¹

A serious and blatant fault is seen as the act or the omission that has a causal link with the bankruptcy and of which the director or the member of the management board was aware, or could not have been unaware that it could cause the bankruptcy. Such a fault, therefore, implies the concept of "*dol*", which is intentional fault or fraudulent gross negligence (*faute dolosive*). The fault becomes blatant if it passes the margin of error allowed under the circumstances. The events are not considered from the vantage point of the particular circumstances of the director or member of the management board at that particular time.

It is a sufficient condition that the directors' or members of the management board's actions have

19. Tribunal d'arrondissement de Luxembourg, 2ème chambre, dated January 10, 1992, no.8/92.

20. Commercial Code art.495-1.

21. The Commercial Court in a judgment dated June 20, 2003 has jointly condemned two directors to pay an amount equivalent to the losses incurred by the company between the date it should have been declared bankrupt and the date it has finally been declared bankrupt (10 months had elapsed). Their fault consisted in the fact they had carried on non-profitable activity for too long with no chance of recovery (wrongful trading). The court decided that:

"By maintaining an activity in deficit until December 98, the directors have committed a serious and blatant fault leading to the company bankruptcy."

The two directors have been condemned to the joint payment of the deficit, although one of them owned 25% of the company shares and the other one 75%.

contributed to the insolvency. For example, it has been held that a complete lack of awareness of or diligence to the company's affairs constitutes a blatant fault. If they failed in their duty to draw up annual accounts as envisaged by the Company Law, and there is evidence that this contributed to the insolvency, then this might also constitute such a blatant fault. It could also be when they intentionally or negligently incur debts while the company is insolvent or has no hope of being able to pay. In this instance, the case law²² requires evidence that—at the time the new credits are incurred—it is clear that the company will never be able to satisfy the creditors.

Such an action can be taken up to three years following the verification of all creditors' claims by the trustee, and the evidence of the blatant fault has to be provided by the trustee.

Ban on trading

Similarly, directors or members of the management board may be prevented from holding different offices if they have committed a serious and blatant offence contributing to the winding-up of the company. The Luxembourg court can prevent them from doing a number of things including pursuing any commercial activity either on their own account or indirectly through a third party; being a director or member of a management board in any other company; being an auditor; or holding any other position in any company by which that person would have the power to bind that company. This ban is automatically imposed in cases of *banqueroute simple* (wrongful bankruptcy) or *banqueroute frauduleuse* (fraudulent bankruptcy).²³

The ban is made on the motion of either the trustee or the public prosecutor within three years from the date of the insolvency judgment. In all cases, such a ban cannot be less than one year nor can it be more than 20 years. It can be revoked or varied in certain cases and will be written in the commercial register of companies.

“Banqueroute simple” and “banqueroute frauduleuse” (wrongful bankruptcy and fraudulent bankruptcy)

Luxembourg law distinguishes between two kinds of personal bankruptcy where directors or members of the management board are held liable

22. Tribunal d'arrondissement de Luxembourg dated December 19, 1997, no.40811 and March 29, 1985, no.35483.

23. Commercial Code art.444-1.

for those acts set out in the law.²⁴ A bankrupt person, company or entity (including directors and members of the management board) can be taken to court both as a *banqueroutier simple* (wrongfully bankrupt) and as a *banqueroutier frauduleux* (fraudulently bankrupt) at the same time.

Both acts are considered criminal but the former is considered less serious than the latter. The reasoning behind having two procedures such as these is that the insolvency proceedings protect creditors whereas the fraudulent bankruptcy proceedings protect public moral conduct, *moralité publique*. The *banqueroute* actions must be thought of as separate public actions that have little to do with any decision that has been made in civil proceedings.

Wrongful bankruptcy applies for up to three years and fraudulent bankruptcy up to 10 years.

Wrongful bankruptcy

A *banqueroutier simple* would be any bankrupt person who fulfilled any of the conditions outlined in arts 573 to 575 of the Luxembourg Commercial Code, especially:

- where the person's personal expenses are found to be excessive;
- with the intention of avoiding or delaying insolvency proceedings, they have made purchases with a view to resell at a higher price or have used other extravagant means to obtain funds;
- if they have assumed expenses or losses or cannot justify the existence or the use of an asset in their last inventory be it cash, valuables, fixtures and fittings that they used before;
- if they have favoured or paid any creditor to the prejudice of others after the cessation of payments;
- where a person has kept manifestly incomplete sets of accounts or kept accounts that do not comply with legal requirements;
- if they have not made petition for bankruptcy within one month of the company's cessation of payments;
- those who in the interest of the bankrupt have concealed, hidden or shielded part or whole of the movable or immovable property of the bankrupt;
- those who have fraudulently submitted during the course of the bankruptcy and stated, be it in their own name or through another, either fictitious or exaggerated debts.

24. Commercial Code arts 573–577.

The Commercial Code provides for an imprisonment for *banqueroutiers simples* of between one month and two years; moreover for the last two cases, a fine between €500 and €30,000 could be imposed.

Fraudulent bankruptcy

Directors and members of the management board shall be deemed to be a fraudulent bankrupt when:

- they have concealed accounts or removed, deleted or altered the contents of the same;
- they have embezzled or concealed a part of the assets;
- they have in their writings, either by public acts or undertakings, entered privately, or in the balance sheet, fraudulently as a debtor someone to whom they do not owe anything.

As well as the consequences envisaged by art.444-1 of the Luxembourg Commercial Code, the criminal penalties for fraudulent bankrupts are severe. The Luxembourg Criminal Code provides for a possible term of imprisonment for *banqueroutiers frauduleux* of between five and ten years.

The particular case of the "twilight period"²⁵

This is the period that can be thought of as the approximate equivalent of what is often referred to as "relevant time" in the United Kingdom under the Insolvency Acts. It is called the *période suspecte* in Luxembourg, and is also referred to as the "twilight period".

Article 442 of the Commercial Code states that the court will determine the date of the beginning of the suspension of payments (*cessation des paiements*). This period can

pre-date the declarative insolvency judgment of the company by a maximum of six months. In the event that no particular date is stated, the date of *cessation des paiements* is deemed to be the date of the opening judgment declaring the company bankrupt.

The consequences of fixing such a date are determined by art.445. There are certain acts listed in the article which will be voided and will not have an effect. These are any transactions roughly equivalent to gratuitous alienations or fraudulent preferences. For example, any payments in cash or any sale or compensation not for valid consideration²⁶ will be void. The law here is trying to prevent a director or member of the management board from alienating or donating the company's assets to the prejudice of its creditors. During this period, the conduct of directors and members of the management board will be investigated by the trustee and, if necessary, reported to the public prosecutor. Consequently, each decision taken by them has to be carefully considered. Once they are aware that the company is in financial difficulties and insolvency seems unavoidable, their duties will include taking professional advice on the matter which may give a director some protection against any allegation of wrongful trading by a trustee. They must, in particular, take positive action to mitigate the consequences for the company's creditors and to reduce as far as possible the potential loss.

Under Luxembourg corporate and insolvency laws, bearing in mind those scandals that have occurred and also the recommendation made by the European Union suggesting the introduction of a European framework rule on "wrongful trading", the directors and members of the management board of a company should behave with caution. They must be vigilant and keep themselves informed of the company's performance and prospects in order to avoid specific liability arising through bankruptcy proceedings.

25. Luxembourg Commercial Code art.442.

26. For example, if the value paid by the bankrupt company is much higher than the value of the goods bought by the company.