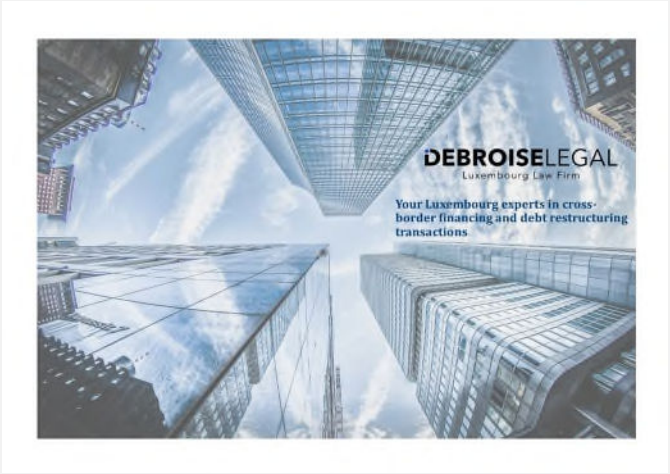
Acquisition Finance – Luxembourg

A comprehensive overview

DEBROISE LEGAL

Luxembourg Law Firm



LUXEMBOURG AS SINGLE POINT OF ENFORCEMENT

INTRODUCTION

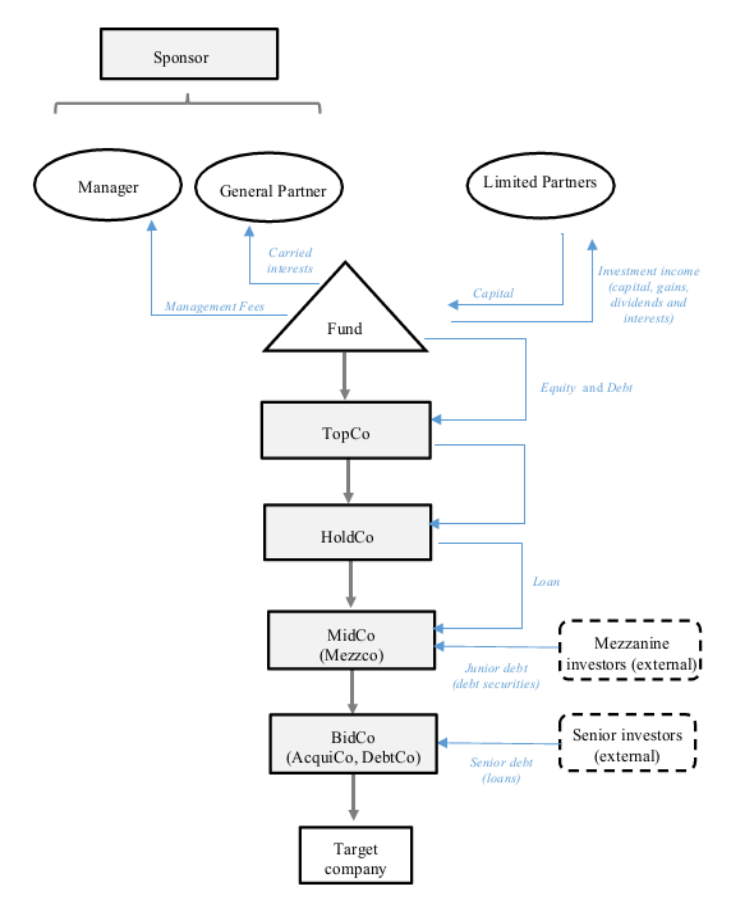
In the context of financing transactions, a single point of enforcement refers to a legal framework that allows creditors to enforce their security interests efficiently and effectively through a single jurisdiction. This approach simplifies enforcement procedures, reduces legal complexities, and provides clarity for parties seeking to enforce their rights across different jurisdictions.

Luxembourg is often chosen for this purpose due to its creditor-friendly laws and efficient enforcement mechanisms.

Other factors such as Luxembourg's combination of tax efficiency, legal flexibility, and stable environment make it a preferred jurisdiction for structuring acquisition transactions through Special Purpose Vehicles (SPVs).

This briefing aims to provide a comprehensive overview of the Luxembourg legal landscape pertinent to acquisition finance. It delves into the corporate vehicles commonly employed and explore certain corporate and regulatory questions that frequently arise in such transactions, including compliance with financial assistance rules, corporate benefit assessments, and adherence to regulatory requirements. Furthermore, it examines the mechanisms for taking and enforcing security interests under Luxembourg law, with particular emphasis on the law of 5 August 2005 on financial collateral arrangements, as amended (the **Luxembourg Financial Collateral Law**).

A TYPICAL LUXEMBOURG PRIVATE EQUITY ACQUISITION STRUCTURE:



SOME CORPORATE AND REGULATORY CONSIDERATIONS

BEHIND THE ACRONYMES

It is easy to be overwhelmed by the number of acronyms associated with Luxembourg companies and investment fund vehicles. To help you navigate the "alphabet soup", outlined below are definitions of some key terms:

Corporate forms

- SA (*société anonyme*) - public limited liability company (managed by a board of directors)
- SARL (*société à responsabilité limitée*) - private limited liability company (managed by a board of managers)
- SCA (*société en commandite par actions*) - partnership limited by shares (similar to a SA but managed by a separate general partner)
- SCS (*société en commandite simple*) - common limited partnership (managed by a general partner)
- SCSp (*société en commandite spéciale*) - special limited partnership (similar to a SCS but without legal personality)

Fund vehicles

- RAIF - Reserved Alternative Investment Fund (unregulated AIF managed by an authorised AIFM and limited to “well-informed” investors)
- Part II UCI – Undertakings for Collective Investment (regulated fund that can be marketed to retail investors subject to certain conditions)
- SIF - Specialised Investment Fund (regulated multi-purpose vehicle for alternative investments limited to “well-informed” investors)
- UCITS - Undertakings for the Collective Investment in Transferable Securities (regulated retail fund)

CORPORATE AUTHORISATIONS

The board of directors (for a SA) or the board of managers (for a SARL) is responsible for the operation and management of a company.

Unless the articles of association of the company reserve certain matters to the general meeting of shareholders, shareholders resolutions are not required to approve the entry into the relevant transaction documents.

CORPORATE BENEFIT TEST

The general principle is that every transaction must be for the corporate benefit of the relevant entity. This benefit can be found for a parent supporting the provision of finance for its subsidiary in the expectation of enhanced economic benefit ultimately upstreaming to the parent. Similarly, a subsidiary may achieve funding on more advantageous terms through participation in a group financing and related security net.

The concept of “group of company” is not recognised in Luxembourg. The interest of the group is not sufficient to assess whether the granting of guarantees or security interests is in the corporate interest of the grantor. However, it is an accepted principle that the requisite individual corporate benefit may also be identified where one group company approves a transaction in favour of another group company, where that transaction:

- is for the purposes of the common economic, financial or corporate interests of the group, which is complimentary to the economic success of each relevant group company
- does not on balance deprive the grantor of the net wider benefit it derives from its group participation, taking account of the obligation undertaken
- does not risk the insolvency of the grantor. In practice, this may often give rise to contractual limitations of recourse under cross- or upstream guarantees to a certain percentage of the net asset value of the grantor

LICENSING REQUIREMENTS

Professionals engaged in granting loans to the public for their own account must obtain the appropriate authorisation. However, there are specific exemptions to this regulatory requirement:

- *one-off transaction*
- *intra-group lending*
- *limited circle of borrowers*: loans granted to a limited circle of predetermined persons are not considered lending to the public
- *high-value loans to professionals*: loans with a nominal value of at least EUR 3,000,000 (or the equivalent in another currency) granted exclusively to professionals are exempt
- *activities governed by special legislation*: certain entities, such as UCI, SIF and securitization vehicles, are out of the scope of the Luxembourg law on financial sector, including those related to lending activities

FINANCIAL ASSISTANCE PROHIBITION

S.A and SCA are prohibited from granting loans, guarantees, security interests or advancing funds to a third party for the acquisition of their own shares. A whitewash procedure exists. The prohibition does not apply to SARL.

PROFESSIONAL PAYMENT GUARANTEES

Parties to such guarantees can tailor the terms of the guarantee to suit their needs, combining elements of traditional suretyship (*cautionnement*) and autonomous guarantees without the risk of requalification as a suretyship. In particular, unless otherwise agreed, the guarantor cannot raise defenses related to the guaranteed claims. The guarantee remains effective even if the principal debtor undergoes insolvency or other similar creditor-related measures.

This regime is particularly valuable for financing transactions, offering a robust tool for risk mitigation and contractual freedom. To benefit from this regime, the guarantee must explicitly refer to the law of 10 July 2020 of professional payment guarantee.

DOUBLE LUXCO STRUCTURE

The development of Double LuxCo structures – utilising two Luxembourg holding companies – was influenced by concerns over the potential shifting of the centre of main interests (COMI) of Luxembourg entities to other jurisdictions.

The purpose of such structure is to ensure that Luxembourg remains the primary jurisdiction for insolvency and legal matters; in particular by requiring that (i) the key management activities, board meetings, and decision-making processes occur in Luxembourg, and (ii) the pledged assets remain located in Luxembourg. In the event of a default, secured parties are entitled to step in, to exercise the voting rights attached to the pledged shares and revoke the (hostile) directors and appoint replacement directors amenable to either stay or withdraw the COMI shifting or the safeguard procedure application or to conduct it in a manner which would take into account the finance parties' views.

ELECTRONIC SIGNATURES

E-signatures are legally recognized and widely used in Luxembourg. As an EU member state, Luxembourg adheres to the eIDAS Regulation (EU Regulation No. 910/2014), which establishes a standardized legal framework for electronic signatures across all EU member countries.

Certain documents, like those requiring notarisation, require handwritten signatures.

CLAW-BACK RULES

Company's contracts can be affected by insolvency procedures if they were concluded during the suspect/hardening period (*période suspecte*) and the preceding 10 days.

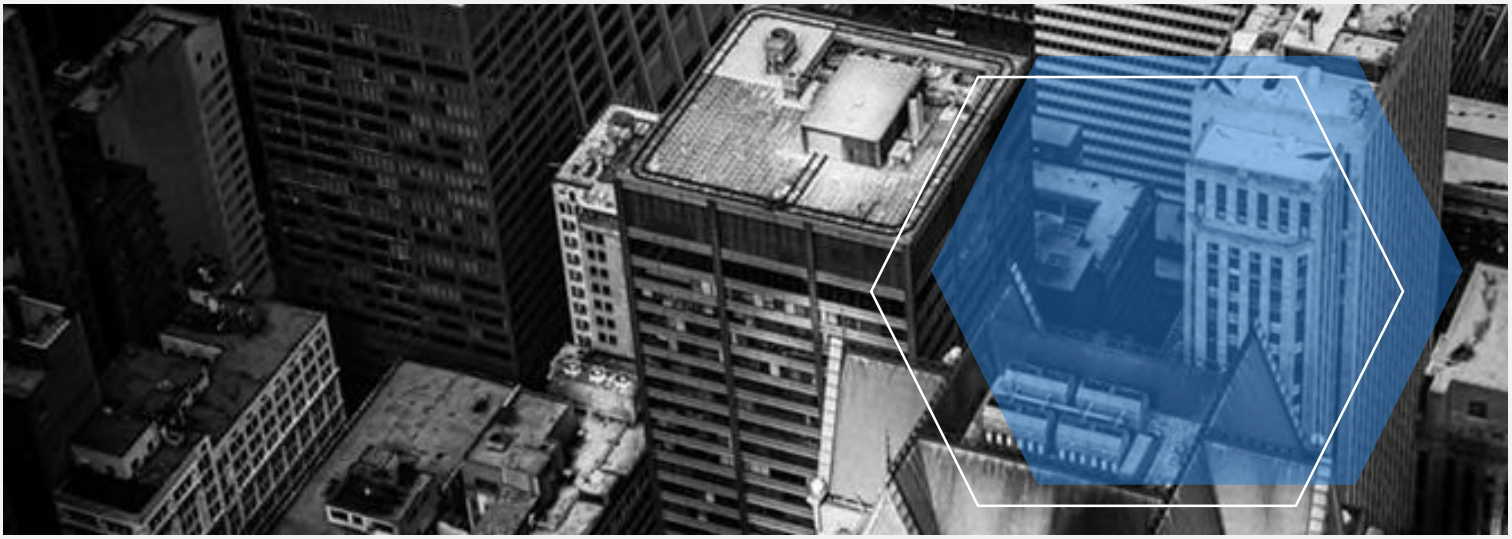
The suspect period starts from the moment the company stopped paying its debts (*cessation des paiements*), though the exact date is fixed by the court (a maximum of 6 months prior to the start of the insolvency procedure).

The following contracts are automatically null and void when concluded during the suspect period:

- contracts entered into by the insolvent company, if its obligations are significantly more onerous than the obligations of the other party
- any payment made by the insolvent company in respect of debts that are not yet due
- any payment made in kind by the insolvent company in respect of debts that are due
- any security granted over an asset of the insolvent company to secure obligations contracted before the cessation of payments

Additionally, any contract or payment can be annulled by the court if the other party had personal knowledge that the company was insolvent.

We will see that security agreements governed by Financial Collateral Law benefit from an immunity against Luxembourg or foreign insolvency proceedings (see below).



A CREDITOR-FRIENDLY FRAMEWORK

SECURITY AGENT/TRUSTEE

The Financial Collateral Law expressly recognises that the contractual rights and proprietary interests of finance parties may be validly held and/or exercised by a security agent/trustee on their behalf, without requiring the principal obligations to be supplemented by parallel debt provisions as required under other civil law systems.

EASE OF CREATION

No formalities are required in relation to the creation of pledge. The attachment of the secured collateral must only be capable of being evidenced in writing.

There is no requirement that security be created by deed or notarial act or be subject to specific execution formalities (e.g. witnessing). Nor are there any public registration requirements.

RANKING

Priority ranks from the date of perfection (unless varied in contract by an intercreditor agreement) of the security.

The Financial Collateral Law expressly recognises the ability to create different ranking pledges over the same secured collateral unless the first ranking pledgee has a contractual right to use and dispose (subject to an obligation to replace with equivalent collateral) the collateral pledged under the security agreement.

FUTURE ASSETS

It is possible for a pledgor to grant security over present and future qualifying collateral (i.e. financial instruments and claims) without the need to designate them specifically (subject however to certain perfection requirements when the relevant assets come into existence).

EASE OF TRANSACTION MANAGEMENT

A high degree of flexibility is specifically provided in Financial Collateral Law in relation to the use of the secured collateral subject to the pledge.

Where that collateral carries a right to vote, for example shares, the right to exercise those votes is determined by the parties in contract. Voting rights can be contractually vested in the security agent, so that it is able to vote the pledged shares prior to any default, for example, upon an attempted COMI migration, or any proposed constitutional amendment impairing shareholder rights to remove current directors or impairing secured creditor rights in relation to secured collateral.

Similarly, whilst perfected, the security remains valid notwithstanding any contractual agreement to permit the security grantor to continue to use the secured collateral. In relation to pledged bank accounts, for example, such accounts may either be operated by the grantor solely with the secured party's consent or in accordance with an agreed payment waterfall or alternatively may be controlled by the grantor for agreed permitted purposes under the facility agreement until blocked by service of a blocking notice.

STAMP DUTIES

No stamp duty or similar tax or charge applies to the creation or enforcement of a specific pledge security interest over shares, bank accounts or receivables.

WITHHOLDING TAX

Proceeds from enforcement of security interests or guarantees are not subject to withholding tax in Luxembourg, except that dividend distributed by a Luxembourg company following such a security enforcement (i.e. as a result of the enforcement of a share pledge) may be subject to a 15% withholding tax in Luxembourg (save for the application of the Luxembourg participation exemption regime or a double tax treaty).

FLEXIBILITY WITH RESPECT TO THE NOTION OF ENFORCEMENT EVENT

Any event can serve as an enforcement event.

It can be events other than payment defaults, such as breaches of financial covenants.

SUBSTANTIAL EXCLUSION OF INSOLVENCY RISK

Certainty for secured parties is enhanced by the disapplication by the Financial Collateral Law' of both Luxembourg and foreign laws relating to bankruptcy, liquidation, reorganisation or similar measures and from any civil, criminal or other judicial attachment or confiscation Court order.

Relevant Luxembourg security, its enforcement and agreed collateral valuation provisions is therefore binding on the insolvency officeholders, may be enforced by the secured party despite any bankruptcy of the security grantor, and, importantly, is not vulnerable to being set aside by reason of any hardening period (*période suspecte*).

The Financial Collateral Law further gives an extraterritorial effect to the above principle by extending the insolvency remote effect to any financial collateral arrangement, or any similar guarantee, granted by a Luxembourg-based entity when such financial collateral arrangement is governed by a law other than Luxembourg law.

EASE OF PERFECTION

Perfection of pledges occurs on (and continues with) the deemed transfer of possession of the secured collateral to either the secured creditor or to an agreed third party custodian. Such deemed transfer of possession is effected under the Financial Collateral Law as follows:

- in relation to shares, by recording the pledge in the share register of the issuer
- in relation to financial instruments transferable by book entry, by noting registration to an account with a custodian, whether in the name of the grantor, secured party or an agreed, third party, noting the pledge

Market practice is to require a certified copy of the share register of the company whose shares are pledged, to be provided at completion.

Similarly, in relation to bank account security, the account bank will be notified of the pledge and will be asked to relinquish any rights of set off, combination of accounts or first ranking pledge in respect of the account collateral which would otherwise apply pursuant to its general terms and conditions.

No government, notarial or other third-party involvement is required for the perfection of such security.

EASE OF ENFORCEMENT

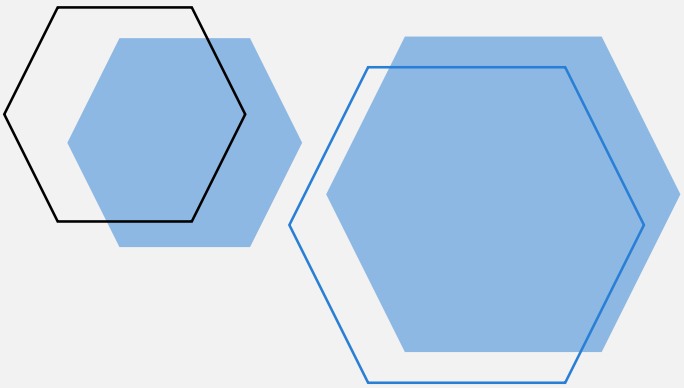
Enforcement may be carried out without the involvement of any public or judicial officer or notary. A formal default notice (*mise en demeure*) to be served prior to enforcement is also not required, although facility agreements will often require the delivery of a notice of acceleration in any event.

With respect to shares, enforcement usually occurs:

- by appropriation of the collateral; or
- by private sale.

The appropriation of the pledged assets at a price determined pursuant to a pre-agreed valuation method is an out-of-court enforcement procedure that does not require the intervention of a public authority. The valuation can be performed after the appropriation has occurred. Furthermore, the pledged assets can be appropriated by the pledgee itself or by any third party designated by it (e.g. a special purpose vehicle wholly owned by the secured creditor or set up as an orphan structure).

Unlike appropriation, a valuation of the assets is not required in the event of the enforcement of a pledge by way of a private sale. Such sale must however always be done in a commercially reasonable manner. As a guidance, a private sale would meet the “normal commercial test” if it has been made at a price that a well-informed independent willing buyer would normally, under relevant market conditions and taking into account the information available at that time, accept to pay to a willing seller.



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ABOUT US

Debroise Legal is a Luxembourg-based boutique law firm dedicated to providing expert legal services in the realm of corporate, financing and restructuring transactions.

Founded by a seasoned lawyer with over 20 years of experience in the Luxembourg legal market, our firm is committed to delivering tailored solutions that meet the specific needs of our clients.

We take pride in being commercial, pragmatic and to the point.

WE ARE HERE TO MAKE IT HAPPEN.

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NAV-Based Lending
Hybrid Facilities

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LBOs
Real Estate Financing
Debt and Equity Financings

Restructuring

Debt restructuring
Security enforcement
Insolvency Proceedings

Corporate

Incorporation
Corporate governance
Shareholder agreements
Sale and purchase agreements

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