Acquisition Finance

Contributing editors
Ryan Bekkerus, Alexandra Kaplan and Marisa Stavenas

2018

GETTING THE DEAL THROUGH

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Simpson Thacher & Bartlett LLP

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
James Spearing
subscriptions@gettingthedealthrough.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Law Business Research

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Acquisition Finance 2018

Sixth edition

Getting the Deal Through is delighted to publish the sixth edition of *Acquisition Finance*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes Argentina, India and Nigeria.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Ryan Bekkerus, Alexandra Kaplan and Marisa Stavenas of Simpson Thacher & Bartlett LLP, for their continued assistance with this volume.

GETTING THE
DEAL THROUGH

London
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Luxembourg

Denis Van den Bulke and Peter-Jan Bossuyt

Vandenbulke

General structuring of financing

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Most financing transactions in Luxembourg are made by inbound foreign professional and institutional financing and banking investors. Transactions tend, therefore, to be governed by the law that is most familiar to the financing parties, which is generally their domestic law (eg, their law of incorporation, English, New York, German or French law). However, most of the contractual agreements relating to the Luxembourg security packages to the extent they relate to Luxembourg securities (acquisition-agreement security packages such as pledges) are governed by Luxembourg law.

Luxembourg law is very liberal and expressly states the principle of freedom of contract, including the choice of law and election of forum (1123 and 1134, paragraph 1 of the Civil Code indirectly). Freedom of contract is, however, limited by mandatory rules and rules of public policy (article 6 of the Civil Code).

The principle jura novit curia does not apply to foreign law. The judge does not automatically raise the conflict of laws rule, which is not mandatory in contractual matters. He or she will apply the conflict of law rule when parties have not opted for a governing law. The parties invoking the foreign law must prove the content of the foreign law, which, for the Luxembourg courts, is a matter of fact.

Choice of law

Luxembourg courts will uphold the choice of law made by the parties to the acquisition agreements. However, Luxembourg courts may exclude application of a provision of the law chosen by the parties if, and to the extent, that the result of that application would be manifestly incompatible with fundamental principles of public policy of the Luxembourg forum or they are required to take into account overriding mandatory provisions of a law.

Rules of choice of law for countries of the EU are determined by Regulation (EC) No. 593/2008 (Rome I) on the law applicable to contractual obligations. Where there has been no choice of law, the applicable law will be determined in accordance with the rule specified for the particular type of contract. Where the contract cannot be categorised as being one of the specified types or where its elements fall within more than one of the specified types, it should be governed by the law of the country where the party required to effect the characteristic performance of the contract has his or her habitual residence. In the case of a contract consisting of a bundle of rights and obligations capable of being categorised as falling within more than one of the specified types of contract, the characteristic performance of the contract will be determined with regard to its centre of gravity.

In the absence of choice, where the applicable law cannot be determined either on the basis of the fact that the contract can be categorised as one of the specified types, or as being the law of the country of habitual residence of the party required to effect the characteristic performance of the contract, the contract should be governed by the law of the country with which it is most closely connected. To determine that country, account will be taken, inter alia, of whether the contract in question has a very close relationship with another contract or contracts.

Enforceability of a judgment

When a judgment has been rendered in a non-EU member state and if no international treaty applies, that judgment will be recognised and enforced in Luxembourg after a review by the Luxembourg Court of First Instance that the conditions set out in article 678 of the Luxembourg Code of Civil Procedure are fulfilled (ie, the usual conditions relating to public policy constraints, the observance by the court of the rights of defence, etc).

When the judgment has been rendered in any EU member state, except Denmark, Regulation (EU) No. 1215/2012 (the Brussels Ibis Regulation), will apply. Similar provisions are provided by the Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters signed in Lugano on 30 October 2007 between the European Union member states and three European Free Trade Association countries: Iceland, Norway and Switzerland. The Brussels Ibis Regulation provides that a judgment delivered in a EU member state, which is enforceable in that member state, shall be enforceable in any other member state without any declaration of enforceability being required (article 39). Pursuant to article 42(1) of the Brussels Ibis Regulation, a party who wishes to enforce a judgment delivered in another member state shall provide the competent enforcement authority with:

- a copy of the judgment that satisfies the conditions necessary to establish its authenticity; and
- a certificate issued by the court of origin in the form provided in Annex I of this regulation.

Notwithstanding the above, the new regulation still provides for grounds to refuse enforcement of a judgment (article 46 et seq of the Brussels Ibis Regulation). These grounds are the same as those for the refusal of recognition of a judgment (article 45 of the Brussels Ibis Regulation):

- if the enforcement is manifestly contrary to the public policy of Luxembourg;
- where the judgment was delivered in default of appearance, if the defendant was not served with the document that instituted the proceedings or with an equivalent document in sufficient time and in such a way as to enable him or her to arrange for his or her defence;
- if the judgment is irreconcilable with a judgment given between the same parties in Luxembourg;
- if the judgment is irreconcilable with an earlier judgment given in another member state or in a third state involving the same cause of action and between the same parties, provided that the earlier judgment fulfils the conditions necessary for its recognition in Luxembourg; or
- if the judgment conflicts with the rules governing the jurisdiction when the policyholder, the insured, a beneficiary of the insurance contract, the injured party, the consumer or the employees was the defendant (articles 10 to 23 of the Brussels Ibis Regulation), and the rules governing the exclusive jurisdiction (article 24 of the same).

Further, Regulation (EC) No. 805/2004 of 21 April 2004 (as amended), creating a European enforcement order for uncontested claims, provides for the abolition of exequatur for judgments on uncontested claims.

A judgment that has been certified as a European enforcement order in another EU member state, other than Denmark, will be recognised and enforced in Luxembourg without the need for a declaration of enforceability and without any possibility of opposing its recognition.

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

There are no restrictions on acquisitions made by foreign entities. In addition, there are no restrictions on cross-border lending. EU credit institutions may provide credit through either a branch or in accordance with rules relating to freedom of provision of services as long as this activity is regulated by the regulatory authorities of their home country. The exercise of this activity on Luxembourg territory is not subject to authorisation by the Luxembourg financial sector supervisory commission.

Intra-group financing is also not subject to regulatory supervision. Other funding can be freely made to Luxembourg entities as long as their activity does not qualify as an activity of the financial sector; namely, the activity is not carried out in a professional and usual way on Luxembourg territory or the funding entity is subject in its territory of origin to a supervision equivalent to that existing in Luxembourg.

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Large acquisition financing in Luxembourg mainly consists of debt and equity-tainted debt instruments (including hybrid debt instruments such as preferred equity certificates, convertible preferred equity certificates, convertible and redeemable bonds), bank loans (straight loans, syndicated loans, etc) and mezzanine loans (by shareholders or other junior lenders). Almost all financing transactions include senior debt (for the largest amount) and junior debt (provided by shareholders, sponsors or other banks). Luxembourg is particularly attractive for setting up acquisition special purpose vehicles (SPVs) to the extent its regulatory environment offers to investors a wide panel of financing and debt instruments endowed with hybrid features likely to optimise the tax efficiency of the acquisition transactions. A sizeable number of international and EU acquisitions are channelled through Luxembourg to benefit from those hybrid features.

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

Takeover bids are governed by the Law dated 19 May 2006 on takeover bids (as amended), implementing Directive 2004/25/EC on takeover bids into Luxembourg law. Pursuant to this law, an offeror must announce a bid only after ensuring that he or she can fulfil in full any cash consideration, if it is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.

Preconditions to the bid are not permitted unless they involve official authorisations or regulatory clearances relating to the bid. This entails that the bid must not normally be made subject to any financing conditions or preconditions (other than regulatory clearances), and that certain funds must be available to implement the bid.

There is no concept of 'certain funds' in Luxembourg law and regulations. However, many Anglo-Saxon private equity funds are active in Luxembourg and they tend to adopt the City Code 'certain funds' requirement in private treaty transactions. Although not legislatively mandated in this context, and so more flexible, it tends to be enforced to the point where the vendor's counsel will carefully scrutinise the bidder's debt funding term sheets for hidden 'outs'. However, this is not a fixed concept and there is plenty of scope to negotiate the important details. In general, critical finance conditions are negotiated and resolved in the early stages of the bid process.

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

There are no legal restrictions on the borrower's use of proceeds from loans or debt securities. However, general prohibition of financial assistance may impose restrictions to the extent the advancing of money or granting of loans providing financial means to enable a third party to purchase existing shares of a public limited liability company (*société anonyme*) is prohibited. The prohibition has been somewhat relaxed through a whitewash procedure (see question 15) but it still stands. Any funding made for purposes of illegal activities are of course prohibited.

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

In principle, there are no licensing requirements for EU entities providing financing to a company organised under the laws of Luxembourg. European rules of freedom to provide services, freedom of capital and freedom of movement will prevail. The law also allows the free branching and freedom to provide services that allow all credit institutions authorised and supervised by the competent authorities of another EU member state (home country) to exercise their activities in Luxembourg (host country) as long as these activities are covered by the authorisation of the home country. Non-EU financing institutions may also lend to Luxembourg companies as long as they are regulated and supervised by their home regulator pursuant to terms and conditions that are deemed equivalent, by the Luxembourg regulatory authorities, to those prevailing in Luxembourg for similar financial institutions. Loan origination activities performed by the following undertakings do not require authorisation as professional lenders:

- undertakings for collective investments;
- alternative investment funds;
- securitisation vehicles;
- specialised investment funds;
- pension funds; or
- investment companies in risk capital.

Similarly, lending activities performed on single or ancillary basis, intragroup lending and loans granted to a limited number of persons do not require authorisation. In a broader sense, any type of funding can be freely granted to Luxembourg entities as long as it does not qualify as a financial sector activity, meaning the lending activity is not carried out in a professional and usual way in Luxembourg or the lender is subject in its home country to prudential supervision equivalent to that exercised by the Luxembourg financial regulator, the CSSF.

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Luxembourg does not impose any withholding tax on interest payments. Accordingly, debt instruments are not subject to withholding tax unless they are requalified as dividends or profit-sharing bonds or notes. This absence of withholding tax on interest makes Luxembourg the preferred jurisdiction for international acquisition finance transactions. By way of derogation, if the beneficial owner of the bonds is an individual taxpayer residing in Luxembourg, a 20 per cent withholding tax shall apply pursuant to the amended law dated 23 December 2005. However, this withholding tax is definitive and is deemed to replace the income tax, which applies to income interest for Luxembourg residents.

If an investor wants to fund the acquisition as far as possible with debt, the Luxembourg tax law is, in general, very flexible and does not impose any strict debt-to-equity ratios on ordinary taxable companies. Informal limits are, however, applied by the tax authorities for the financing of an acquisition of a subsidiary by intragroup loans. In this situation, the Luxembourg tax authorities generally consider a ratio of 85:15 as being in line with the arm's-length principle, which means that up to 85 per cent of the purchase price of the participations can be financed by intragroup loans. Interest rates of the intragroup loans must be in line with the arm's-length principles in accordance with transfer pricing regulations in Luxembourg. This may be further affected by Directive 2016/1164/EU (Anti-Tax Avoidance Directive), to be transposed into national law by 31 December 2018. The upcoming exit of the United Kingdom from the European Union should not have a priori any adverse effect when structuring the acquisition finance between Luxembourg and the UK, because the applicable zero rate withholding tax pursuant to Directive 2003/48/EC (EU Savings Directive) would be substituted by the provisions of the double tax treaty between Luxembourg and the UK, which currently provides for a full exemption on interest payments.

For the purposes of determining the debt-to-equity ratio, an interest-free loan from shareholders may be treated as equity for corporate income tax purposes, so it may be possible to structure funding with a 99:1 interest-free or bearing debt-to-equity ratio. A debt-to-equity ratio of 99:1 could also be achieved by using certain exit instruments such as tracking loans. Such a funding structure should be analysed on a case-by-case basis. Any excess interest payments that result from an excess over the above debt-to-equity ratio would be reclassified as hidden profit distribution, therefore leading to a requalification of interest payments into dividend distribution, which, tax-wise, is subject to a tax rate of 15 per cent that is generally applicable on dividends payments, unless the recipient qualifies for the affiliation privilege in Luxembourg.

Finally, gross-up provisions are common in lending documentation and the borrower is usually required to gross-up its payment against any withholding tax that would apply on interest payments.

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Article 494 of the Luxembourg Penal Code provides that whoever, by exploiting a borrower's weaknesses, obtains a rate exceeding the legal interest (annually fixed through a Grand-Ducal Regulation, equal to 2.25 per cent a year for 2017 and not yet set for 2018) can be sentenced to imprisonment of one month to one year and pay fines ranging from €500 to €25,000, or either one of these penalties. Further, if the lender voluntarily abuses the borrower's need or inexperience to achieve an interest rate clearly exceeding the normal rate in respect of the risk coverage of the loan, the judge, at the request of the borrower, can reduce its obligations to repay the loan capital and the payment of interest.

Another rule of public policy forbids the lender to demand interest on interest (prohibition of anatocism). The principle of anatocism (governed by article 1154 of the Luxembourg Civil Code) limits the frequency at which interest can be compounded on interest; interest can only be compounded once a year, provided the interest is due at that moment in time.

The principle of freedom of contract is further limited by the general duty of care. Parties should act reasonably and fairly when negotiating, executing and performing a contract. The principle of due care sometimes allows the judge to intervene when a party's negotiating position would result in unreasonable contractual provisions for the other party, including imbalance between the parties' interests.

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Bank lenders

Most of the lending agreement will typically follow Anglo-Saxon formats and tend to favour the lenders. Provisions in agreements can indemnify lenders and agents against all liabilities, losses, costs or expenses arising out of the negotiation, execution, delivery, performance, administration or enforcement of the transaction documents, including pursuant to any proceedings or in connection with the borrower's use of proceeds of such financing. Indemnities typically cover reasonable fees and expenses of legal counsel but are sometimes limited to one principal legal counsel for all such parties and one local counsel in each relevant jurisdiction. Lenders and agents are generally not indemnified to the extent that any such losses or liabilities are caused by their own gross negligence, bad faith or wilful misconduct (and, sometimes, if caused by a material breach by them of the loan agreement) and many contracts will provide that such finding must be made in a final and non-appealable determination by a court of competent jurisdiction.

Securities holders

Holders of securities initially issued to underwriters or initial purchasers are not indemnified by their issuers, except for taxes for which a 'gross up' is payable, as discussed in question 7. Issuers of securities typically indemnify underwriters and initial purchasers against certain liabilities, including liabilities under securities laws, or agree to contribute to payments such parties may be required to make in respect of those liabilities. Trustees and collateral agents are typically indemnified by the issuer for any loss, liability, damage, claim or expense incurred by them without negligence or bad faith and wilful misconduct (or such similar provision as the parties may negotiate) on their part arising out of or in connection with the administration of the indenture or collateral documents under which the securities are governed and their duties thereunder.

10 Can interests in debt be freely assigned among lenders?

Debts (including claims for interest) may be assigned by a creditor to a third party without the consent of the debtor. However, restrictions on assignments may be contractually imposed and negotiated in the credit documentation.

For the assignment to be effective towards the debtor and third parties other than the assignee, the debtor must be notified of the assignment (by letter or by the service of a bailiff) or must assent to the assignment (by private deed or notarised deed).

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

There are no specific regulations governing whether an entity can act as an administrative agent for bank financing.

The Law of 10 August 1915 on Commercial Companies, as amended (the Company Law) provides the appointment of a fiduciary agent (to some extent equivalent to a trustee) in certain types of companies such as public companies limited by shares that have issued bonds. Such a trustee will act as representative of the bondholders and undertake certain responsibilities set out in the law.

The Law of 22 March 2004 on Securitisation Companies also provides for the appointment of a fiduciary agent under certain conditions, in particular when the securitisation operation is structured as a transparent fund.

Luxembourg has adopted the Law of 23 July 2003 on Trusts and Fiduciary Agreements (the Law of 23 July 2003), bringing into force the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985. Although it is not possible to create a trust in the Anglo-Saxon sense in Luxembourg, trusts governed by foreign law are recognised in Luxembourg to the extent that they are authorised by the law of the jurisdiction in which they are created.

The adoption of the Law of 23 July 2003 also introduced in Luxembourg a specific regime equivalent to the trust institution, known as the fiduciary agreement. The undertaking of the role of fiduciary agent is, however, limited to financial institutions and certain professionals of the financial sector. A fiduciary agreement can be easily implemented (there are no registration or publication requirements) and is effective towards third parties upon its execution, without further notification requirements. An assignment of debt to a trust is enforceable against third parties upon its execution.

12 May a borrower or financial sponsor conduct a debt buy-back?

A borrower may, from time to time, proceed to the buy-back of debts. However, although legal provisions regulate and organise the redemption of shares, no legal provisions govern debt buy-back. Buy-backs are a matter of contractual negotiations. Junior and senior debt have been heavily bought back in recent years, with the view to benefit from discounted values in a distressed environment.

There is some variation in buy-back provisions but the most typical formulations in large global transactions with sophisticated investors permit purchases by both the borrower and a sponsor subject to ensure equal treatment between debtors and transparent information to all investors.

Securities financings

There are many alternatives for an issuer to repurchase its securities including privately negotiated transactions, open market purchases, cash tender offers and exchange offers. Sponsors may purchase securities, but, under the indenture, affiliates are typically not permitted to vote debt securities owned by them.

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Yes. In this matter, as in others, the freedom of contract prevails. Modification of contractual provisions will generally require the obtaining of consent of a majority of lenders in the context of securities financing. Such consent solicitations may enable a company to remove or relax covenants or events of default (either in respect of a particular contemplated transaction or permanently), which, if approved, will be binding on all holders regardless of whether they consent or not. Consent solicitations can be conducted either alone or jointly with a tender offer (ie, holders deliver their exit consent).

Provisions authorised to be amended are generally strictly listed. The majority ratio necessary to obtain a consent can be fixed either in value (percentage of total loan) or in number of lenders (percentage of number of lenders out of total number of lenders) or both criteria. In addition, under the terms of most loan agreements, certain provisions require the consent of a greater percentage of lenders, each lender or each affected lender. However, agreed changes amending the securities' features should not be so substantial as to affect the nature of the securities and trigger adverse tax effects on the Luxembourg SPVs.

Guarantees and collateral

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no particular taxes, costs or liabilities charges over a guarantee. No stamp duty or similar tax or charge applies to the creation or enforcement of a specific pledge security interest over movable assets such as shares, bank accounts or receivables; nor are there any public registration requirements.

Registration at the mortgage registry, which is only valid for a duration of 10 years (but is renewable), will entail additional costs. Specific fees apply to securities taken over immovable properties when filed and registered in the mortgage registry. A tax of 0.05 per cent on the total amount of the secured debt for first registration and renewal is levied for mortgage or pledge on a going concern. Pledges on real property are subject to a tax of 1 per cent on the total amount of the secured debt. In addition, mortgages can be entered into by way of filing a notarial deed, which entails additional costs. Notary fees are calculated on a sliding scale, based on the value of the mortgaged or pledged property, or the amount secured if the security is over a going concern. A notarial deed is not strictly required for a real estate pledge or pledge on a going concern but is recommended.

The usual sliding scale is as follows:

- €50 to €3,800: 0.3 to 4 per cent;
- €3,800 to €10,000: 0.15 to 1.5 per cent;
- €10,000 to €50,000: 0.1 to 0.6 per cent;
- €50,000 to €100,000: 0.025 to 0.5 per cent;
- €100,000 to €990,000: 0.01 to 0.1 per cent; and
- €990,000 to €1.25 million: 0.01 to 0.05 per cent.

There is no restriction applying to foreign-registered related companies to provide guarantees in Luxembourg or under Luxembourg law.

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

As a general principle, it is unlawful for a Luxembourg limited liability company incorporated in the form of a public limited liability company and for companies generally governed by rules applicable to it to provide financial assistance for the acquisition of its own shares by a third party (subject to certain exceptions). Luxembourg law does not elaborate further on what constitutes prohibited financial assistance. Article 430-19 of the Company Law (formerly article 49-6) provides that a public limited liability company may not directly or indirectly advance funds, grant loans or provide security with a view to the acquisition of its own shares by a third party.

There are several limited exceptions to the general prohibition. For example, it does not apply to transactions undertaken as part of banks' and other finance professionals' usual business, nor to transactions in which the shares are acquired by or for employees of the target.

A breach of the financial assistance prohibition may result in civil and criminal liability for the target's directors. Third-party lenders may face civil liability and the transaction may be annulled.

Since 10 June 2009, a whitewash procedure has been introduced into the law intended to facilitate the restructuring of the shareholding of public limited liability companies, while still protecting the interests of minority shareholders and creditors. Financial assistance is allowed provided the company complies with the 'whitewash procedure', which requires, inter alia, that the transaction be carried out at fair market conditions, the company have distributable reserves in the amount of the financial assistance granted, and the transaction be approved by the shareholders, subject to a detailed published management report on the transaction.

Article 430-20- of the Company Law (formerly article 49-6 bis) provides for special rules that apply where there is a conflict of interest between the parties involved in the purchase of the shares and those in charge or involved in the whitewash procedure.

Given the fact that the level of net assets of a Luxembourg holding company or SPV is generally low, the effect of the whitewash procedure is rather reduced considering that the company needs to allocate from its profits an amount of non-distributable reserves at least equal to the value of the financial assistance granted.

There may also be limitations where cross-group or upstream guarantees by subsidiaries of the borrower are being granted. Lacking a definition of 'group of companies' in Luxembourg law whereby the interests of the group could override those of a single company, the validity of cross-stream or upstream guarantees will ultimately depend on a corporate benefit analysis by the grantor. In particular, the guarantor should have some individual interest (consideration) in the transaction and the expected benefit deriving from the guarantee should outweigh the risks taken in granting the cross-stream or upstream guarantee. The financial liability resulting from a guarantee should not exceed the financial capacity of the guarantor and, more specifically, should not send the guarantor into an insolvent position. In practice, this may often give rise to contractual limitations of recourse, however disputable, under cross-group guarantees to a certain percentage of the net asset value of the grantor.

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Security interests available under Luxembourg law can be divided into:

- securities over immovable assets, which include mortgage over land, building and vessels; and
- securities over movable assets, which include:
    - securities over financial instruments (pledge over shares, claims, bank accounts, debt instruments, assignment of title by way of security), which are governed by the Law of 5 August 2005 on Financial Collateral;
    - pledges over goods or tangible assets that are not financial instruments;
    - pledges over business assets, which is a general security covering the value of a company's intangible assets (eg, clientele, business model, trademark, patents, lease rights, etc and up to 50 per cent of the stock of the company), which can only be granted to banks, credit institutions and breweries being accredited by the Luxembourg Minister of Finance;
    - preservation of title on tangible assets; and
    - retention rights under a sale or warehouse contract.

Luxembourg law also provides for specific guarantees such as personal, independent or joint guarantees or even partial assignment of salary in favour of a creditor.

Luxembourg law does not provide for the creation of fixed and floating charges. It is, however, often the case in international transactions that a Luxembourg company grants a fixed or floating charge governed by foreign law (for further information about enforceability, see question 1).

It is possible to grant a security on all future movable assets of the debtor (not on future immovable assets), but the 'blanket lien' does not exist under Luxembourg law.

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Under Luxembourg law, the transfer of the possession (dispossession) of the assets over which the pledge is granted is a condition to the constitution of the pledge. Such dispossession can be done in various ways depending on the type of assets to be pledged. Dispossession is also required to make the pledge enforceable against third parties. The law of the pledgor's jurisdiction may impose further perfection or notification requirements.

The dispossession of registered financial instruments whose transfer takes place by a transfer in the registers of the issuer (as this is the case with respect to the shares in public company limited by shares) may be established by recording the pledge in those registers.

A pledge created over shares in a private limited liability company has to be notified to the company whose shares are pledged.

Unless the debtor whose claims are pledged is party to the pledge agreement, such pledge agreement must be notified to, or acknowledged by, the debtor. Lacking such notification, the debtor of a pledged claim may validly discharge his or her obligation to the pledgor as long as he or she has no knowledge of the mere conclusion of the pledge.

A pledge over bank accounts must be notified to, and acknowledged by, the account bank maintaining the accounts.

A security interests granted over immovable assets (mortgage) or business assets must be registered with the local mortgage registration office.

Failure to comply with these provisions could jeopardise the enforceability of the security interest and its ranking towards third parties and other creditors.

The perfection of security interests over immovable assets (mortgage) or business assets must be registered with the local mortgage registration office.

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Luxembourg security interests are accessory in nature and continue to exist as long as the principal claim they secure is in place, hence no renewal procedure is required. However, by derogation, a pledge over business assets and a mortgage over immovable properties are only valid for a duration of 10 years (but are renewable).

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

No. 'Works council' consent is not required.

It is recommended to ensure that the granting of guarantees and securities be approved by the grantor itself (ie, its board or relevant authorised corporate body) with the view to assess and ascertain that the granting of guarantees or security satisfies the corporate interest of the grantor and any conflict of interest be cleared.

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

The Financial Collateral Law specifically provides that a security over financial instruments can be granted to an agent or a trustee acting for itself and for the benefit of all lenders, to secure the claims of third-party beneficiaries, present or future, provided the third-party beneficiaries are determined or determinable.

For other types of securities (including fiduciary arrangements), the effect of the agency provisions (whether governed by Luxembourg or foreign laws) will be recognised and enforceable in Luxembourg. It is, however, recommended to specify the capacity in which the security beneficiary is acting in the relevant security agreement. For all security interests that fall outside the scope of the Financial Collateral Law and where such security is granted to an agent or a trustee, parallel debt provisions will need to be put in place in the loan documentation.

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

In general, the circumstances under which collateral may be released are specified in the security agreement or the credit agreement, where applicable. Collateral is generally released when full discharge of secured obligations occurs. To the extent that the relevant provision does not permit the automatic release of collateral, the consent of the lenders or holders will be required to release the collateral according to the contractual negotiated terms.

22 Describe the fraudulent transfer laws in your jurisdiction.

Under Luxembourg bankruptcy law, the incurring of debt or the granting of a security interest in collateral in connection with it could be voided under certain condition (see question 33).

Debt commitment letters and acquisition agreements

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short form or long form debt commitment letters used and when is full documentation required?

In most cases, debt commitments are governed by foreign laws. Legal techniques and the sequence of documentation prevailing in Anglo-Saxon legal practices are customarily used in Luxembourg. There is, therefore, no standard practice in Luxembourg, and the full set of documents would be familiar to Anglo-Saxon investors.

In the initial steps towards the transaction, acquisition finance documents will usually include a letter of intent, a commitment letter issued by the bank or financing parties, or both, a term-sheet, a fee letter and, to the extent a capital markets transaction is involved in the acquisition financing, an engagement letter and often a fee credit letter.

The closing documentation will typically include a credit facility agreement, with the financing banks or loan agreements with financing parties, whether subordinated or not, and various finance documents that would comprise a 'security package' including:

- pledge over receivables;
- pledge over shares;
- pledges over bank accounts and other charges on movable and immovable assets with forms of all required notices to be sent under the security documents;
- any hedging arrangements;
- subordination agreements and intercreditor agreements;
- equity documents; and
- utilisation requests.

English concepts of debenture are not used in Luxembourg in as much as this type of general security is unlikely to be enforceable under Luxembourg law.

Apart from the commitment letter and letter of intent, the documentation is contemporaneously signed on the day of the closing of the acquisition. Signing in counterparts has now become a common practice in Luxembourg and exchange of executed documentation by fax and electronic copy (with originals to be provided later on) is validly recognised. Luxembourg law requires, however, that the same number of original agreements be signed as the number of parties to the agreements involved in the transaction.

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Best efforts commitments remain unusual. Transactions are carried out in Luxembourg when the acquisition deal has been secured through fully underwritten commitments in connection with acquisition financing. Luxembourg, being mainly a platform elected for its 'tax appeal', as a secured creditor-friendly jurisdiction and ease of public quotation and pragmatic contractual enforcement, is a jurisdiction resorted to by parties when the deal is nearly completed and all financing details have been resolved. Because closing occurs when financing is secured, it is unusual to negotiate a transaction in Luxembourg whose financing remains uncertain. Good faith in negotiations also remains a requirement and any negotiator may be liable in tort if he or she acted in bad faith in the pre-contractual phase of negotiations without any intent to commit him or herself.

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The conditions precedent list may have a variable perimeter according to the bargaining power and existing trust of parties. Some of the more frequent typical conditions are:

- due diligence: legal and financing (including audited and unaudited financial statements and of pro forma financial statements);
- review of good standing of corporate borrower;

Update and trends

Regulation (EU) No. 2015/848 on insolvency proceedings (Recast Regulation) came into force on 26 June 2017 and repealed Regulation (EU) No. 1346/2000, which fills the gaps left by the repealed regulation and enhances the effective administration of cross-border insolvency proceedings. The Recast Regulation encompasses pre-insolvency (quasi-collective procedures at pre-insolvency stage) and hybrid proceedings (the debtor retaining some control over its assets, albeit subject to supervision by a court or an insolvency practitioner) and aims to establish insolvency registers in each member state that set out information concerning insolvency proceedings opened in such jurisdictions.

The Luxembourg parliament is currently discussing the implementation of the European Union Fourth Anti-Money Laundering Directive (2015/849/EU), which should have been transposed under national law by 26 June 2017. The transposing draft bill endorses a new holistic and risk-based approach enabling the professionals, subject to this legislation, to adapt their level of vigilance in accordance with the identified risks of money laundering or terrorism financing.

- report on title (real estate);
- tax clearance on the acquisition structure and structure memorandum;
- corporate conditions precedent: existence, authorisation, capacity to enter into the contractual documentation including directors' and managers' certificates and in some recent cases solvency certificates issued by the Chief Financial Officer of borrowers;
- funds-flow statement;
- legal opinions from counsel on borrower or target, or both;
- no business material adverse change;
- consummation of the acquisition pursuant to the acquisition agreement;
- completion of marketing period and receipt of customary syndication or disclosure information;
- execution and delivery of documentation;
- perfection of security interests;
- delivery of an offering document suitable for marketing any securities;
- payment of fees;
- receipt of know-your-customer and anti-money laundering rules and regulations; and
- the accuracy of certain acquisition agreement representations made by the target as well as other basic corporate and legal representations made by the borrower in the credit agreement.

Representations are generally repeated at each new drawdown.

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Luxembourg banking and financial institutions are not geared towards large financing or syndications. In addition, they tend to focus their strategy more on private banking activities than on investment banking or commercial credit. Most of the financing operations are carried out by European branches of US or UK banks, or UK branches of French or German financial institutions. Each of them tends to deal according to their national market practices.

Flex provisions have been increasingly predominant in the post-leveraged buyout (LBO) boom and continue to be a key protection for arrangers. The arrangers negotiate the authority to modify the terms of the committed debt, including rights to reallocate the debt among tranches or to allocate a portion of the committed amount to newly created tranches or subordinated facilities. In addition, financings include pricing flex at levels substantially higher than expected market-clearing prices and impose additional adjustments for changes in market indices. Other provisions include excess cash flow sweep (increase in percentage subject to sweep) or increase of financing ceilings.

Some observers also comment that arrangers continue to be 'reluctant to underwrite particular covenant levels and definitions or sponsors' forms of documents'.

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Arrangers have the right to require the borrower to replace the bridge loan with a permanent financing package. Bridge financing would ordinarily finance initial capital expenditure investments.

Bridge financing can also frequently be secured by the issuance of free warrants entitled to acquire equity interests or other debt-equity instruments having tax hybrid characteristics, allowing tax deductions in the target countries and exemption on income in the lender's jurisdictions. Demands to place pre-closing securities in escrow before financing are not frequent, owing to corporate law constraints on the ease to proceed to the issuance of securities in advance or on demand.

Tax-driven instruments would be the most favoured type of securities with the view to optimise the tax efficiency of the LBO. These techniques are generally adopted for the most part by private equity houses in deal acquisition. The terms and conditions of the securities would usually be those prevailing in the markets in which the syndicated banks compete for financing. Terms of securities would be negotiated on a case-by-case basis and include various features such as secured against unsecured, quoted or non-quoted with a maximum number of demands for securities with a minimum issuance amount for each call. Financing conditions would also set the weighted average yield for all securities to be issued irrespective of their tranches and time of issuance.

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Foreign acquirers or lenders want to know that most of the contractual provisions protecting their rights, subject to foreign law, will be fully enforceable in Luxembourg against the Luxembourg special purpose vehicle (SPV). Much care would be addressed to representations relating to valid corporate authority and the binding effects of the contractual agreements. Lenders will rely heavily on local counsel to obtain confirmation, under a formal legal opinion, of the validity and compatibility of contractual provisions with Luxembourg law: validity and enforceability of a non-recourse clause, upstream guarantee or subordination provisions will be heavily scrutinised and security packages would be fiercely negotiated. In particular, provisions entitling the enforcement of loan agreements in distressed situations would be key in the Luxembourg negotiations with the view to enabling lenders to recover their investments in insolvency situations.

In addition, lenders will be sensitive to any tax frictions that the use of a Luxembourg SPV could generate. Specific representations and covenants will be negotiated to this effect and assurance that tax treatment of the financing and acquisition operations has been secured remains paramount.

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

No filing requirements apply to commitment letters, and acquisition agreements remain private and are protected by the law on privacy.

Enforcement of claims and insolvency

30 What restrictions are there on the ability of lenders to enforce against collateral?

Luxembourg is known as one of the best business places in the world and, in particular, to enforce collateral. Luxembourg's business law is very flexible in this respect and the Financial Collateral Law has brought additional protection for enforcement of collateral over financial instruments.

Securities subject to the Financial Collateral Law and real securities (eg, mortgages) are not affected by the insolvency of the debtor and may be enforced in spite of the filing of a petition for bankruptcy or other collective proceeding, whether occurring in Luxembourg or abroad.

Contracts in going concerns are not automatically terminated by the effect of a bankruptcy of the debtor (except for employment contracts). However, contracts that may not be continued during the insolvent period usually terminate. All interest accruals stop from the date on which the bankruptcy has been declared, except when the debt is subject to a security.

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

There is no equivalent concept under Luxembourg law.

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

Upon the declaration of bankruptcy of a company, an automatic stay arises, prohibiting the collection of claims against the bankrupt entity. Secured creditors benefiting from certain type of securities (eg, pledge or mortgage) may, however, enforce their rights under certain conditions. Creditors benefiting from a security on financial instruments are never prevented from enforcing their rights, provided the security was created before the opening of the bankruptcy.

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders? What are the rules for such clawbacks and what period is covered?

Transactions can only be clawed back or challenged in a bankruptcy. A clawback is initiated by the receiver and debated in court. Only specific transactions can be challenged.

Transactions entered into during the hardening period may be declared invalid if they constitute the preferential satisfaction of one creditor over another.

The rights of creditors benefiting from a security governed by the Financial Collateral Law, even granted during the hardening period, are not affected by a bankruptcy or reorganisation proceedings and therefore remain enforceable.

The court can cancel the following transactions:

- disposals of assets without adequate consideration;
- payments made for debts not yet due;
- payments of due debts by means other than cash or bills of exchange; and
- granting of any security for a debt contracted before the hardening period.

Any payment for accrued debt or any transactions against money made after a company has ceased its payments and before the bankruptcy judgment may be cancelled by the court if the beneficiary of the payment or the contracting party was aware of the debtor's cessation of payments.

Mortgages granted during the hardening period (or 10 days before) may be cancelled if their registration was not carried out within 15 days of conclusion of the mortgage deed.

As a general principle, payments made fraudulently and without regard to the creditors' rights are void irrespective of the day on which they were made.

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Secured creditors benefiting from valid securities are entitled to payment prior to unsecured creditors. The law provides for a 'waterfall' or ranking for the payment of certain claims owed to privileged creditors.

The ranking set out by law is as follows:

- judicial expenses costs, including the fees of the trustee or receiver appointed by the court;
- compensation for victims of an accident and funeral costs;
- unpaid wages or salaries of employees of the insolvent company;
- tax and social security claims;
- specific privileges on movable assets (as opposed to general privileges, specific privileges can only be enforced on specific assets of the debtor, eg, rents can be secured by the furniture of the rented premises);
- general privileges on movable and immovable assets (which can be enforced on all of the assets belonging to the debtor);
- specific privileges on immovable assets (which can only be enforced on specific assets, such as the seller's lien or the lender's lien, whose rights can solely be secured by the immovable asset purchased by the debtor);
- mortgages;
- pledges; and
- unsecured creditors.

Thereafter, there are contractually or statutorily subordinated debt claims and then equity interests. The ranking of the subordinated creditors depends on the respective ranking contractually agreed.

Within each category of securities, the ranking of creditors generally follows the rule prior tempore, potior jure and is determined as follows:

- mortgage: if the borrower becomes insolvent, the lenders are repaid in the order of the respective mortgage registration;
- seller's lien: if there has been more than one sale of property to the borrower subject to seller's liens, the first seller is paid first, the second seller is paid second and so on;
- privileges: these interests (such as a seller's lien) grant priority to the creditors, even against creditors with a registered mortgage; and
- pledge: if there is more than one pledge over the same assets, the date on which it was made effective towards third parties (eg, registration or notification, as the case may be) determines their ranking.

In order for a plan of reorganisation (controlled management) to be approved, the creditors must vote in favour of the plan by a majority of the creditors representing more than half of the company's claims. Once approved, the plan is effective towards all the creditors.

VANDENBULKE
CORPORATE, FINANCE AND TAX LAWYERS

Denis Van den Bulke **dv@vdblaw.com**
Peter-Jan Bossuyt **pjb@vdblaw.com**

35 Avenue Monterey
2163 Luxembourg

Tel: +352 26 38 33 50
Fax: +352 26 38 33 49
www.vdblaw.com

Security interests granted to creditors over financial instruments or claims under the Financial Collateral Law remain enforceable despite the opening of a bankruptcy or reorganisation proceedings.

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Under Luxembourg law, no legal provision exists preventing creditors from agreeing on the rank of their claims. Case law and Luxembourg legal scholars recognise the validity of contractual subordination arrangements. Such agreements are effective towards third parties and courts would normally enforce them.

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

All interest accruals stop from the date on which the bankruptcy was declared, except when the debt is subject to a security. The discount on securities corresponds to unaccrued and unmatured interest.

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

Generally, a secured creditor that forecloses on collateral takes the collateral 'as it is' with any potential liabilities against which the collateral is subject. This is particularly the case in the event of appropriation and realisation of the assets subject to the security. The security being customarily in rem, all liabilities follow the collateral.

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