

Luxembourg

Denis Van den Bulke and Laurence Jacques

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 of the 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 which is most familiar to the financing party, generally their domestic law (eg, their law of incorporation, be it UK, US or French law). However, most contractual agreements relating to the security packages to the extent they relate to Luxembourg securities (acquisition agreement security packages such as pledge) 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. Freedom of contract is, however, limited by mandatory rules and rules of public policy.

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. The court 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 the application of a provision of the law chosen by the parties if and to the extent that the result of such application would be manifestly incompatible with fundamental notions of public policy (*ordre public*) of the Luxembourg forum or they are required to take into account overriding mandatory provisions of a law.

Effect should nevertheless be given to those mandatory rules of national, supranational and international law which, according to the relevant rules of private international law, are applicable irrespective of the law governing the contract.

Rules of choice of law for countries of the EU are determined by the Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). 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 its 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 having 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 judgment

When the judgment has been rendered in a non-EU member state and if no international treaty applies, such a judgment will be recognised and enforced in Luxembourg after a review by the Luxembourg First Instance Court 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 an EU member state, including Denmark (since 1 July 2007), the Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgment in civil and commercial matters (Regulation (EC) No. 44/2001) will apply. Similar provisions are provided by the Convention on jurisdiction and the recognition and enforcement of judgment in civil and commercial matters signed in Lugano on 30 October 2007 between the EU member states and three EFTA countries: Iceland, Norway and Switzerland. A judgment handed down by a court of competent jurisdiction of such EU member state must be recognised and may be enforced in Luxembourg without a review of the merits of the case, in accordance with the conditions set out in Regulation (EC) No. 44/2001.

Nevertheless, Luxembourg Courts will check, within the strict limits imposed by the Regulation (EC) No. 44/2001, the regularity of the judgments with respect to:

- the international and national competence of the foreign jurisdiction;
- the application of the competent law; and
- the applied procedure.

In addition, Luxembourg Courts will recognise the enforceability of the judgments on condition that:

- the judgment is enforceable in the foreign jurisdiction;
- the judgment is not contrary to public policy in Luxembourg;
- the defaulting defendant was served with the summons correctly and in good time for him to arrange for his defence;
- the judgment is compatible with any judgments rendered in a dispute between the same parties in Luxembourg;

- the judgment does not conflict with a prior judgment rendered in a third-country between the same parties for the same object and cause, to the extent such a judgment rendered in a third-country is enforceable in Luxembourg; and
- the party applying for enforcement produces:
 - a copy of the judgment, meeting the conditions necessary for authenticity;
 - in the event of a judgment by default, the original or a certified true copy of the document establishing that the summons have been served on the defaulting party;
 - all documents for the purpose of establishing that, in accordance with its originating law, the judgment is enforceable and has been served; and
 - a sworn translation of the judgment in French or German made by a sworn translator qualified in Luxembourg.

It should also be further noted that Regulation (EC) 805/2004 of 21 April 2004 creating a European Enforcement Order for uncontested claims provides for the abolition of exequatur for judgments on uncontested claims.

A judgment which has been certified as a European Enforcement Order in another EU member state, except Denmark, shall 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 so long as this activity is regulated by the regulatory authorities of their home country. The exercise of this activity on the Luxembourg territory is not subject to authorisation by the Luxembourg supervisory authority.

Intra-group financing is also not subject to regulatory supervision. Other funding can be freely made to Luxembourg entities so long as their activity does not qualify as an activity of the financial sector (ie, the activity is not carried out in a professional and usual way on the 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 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 channeled 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, implementing Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids into Luxembourg law. Pursuant to this law, an offeror must announce a bid only after ensuring that he can fulfil in full any cash consideration, if such 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), that certain funds must be available to implement the bid.

There is no such '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 the company is prohibited. The prohibition has been somewhat relaxed through a whitewash procedure (see question 15) but it remains. Any funding of illegal activities is, 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 would prevail. The law also allows the free branching or freedom to provide services which allows all credit institution 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 so 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 the one prevailing in Luxembourg for similar financial institutions.

- 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?

In the case of leveraged acquisitions, Luxembourg companies are generally not subject to withholding tax on interest payments, except in very limited cases (eg, profit-sharing bonds or notes), or if the payment falls within the scope of:

- the EU Directive 2003/48/EC on taxation of savings income and the beneficiary has not opted out of the exchange of information; or
- the Luxembourg law dated 23 December 2005, under which payments of interest or similar income made since 1 January 2006 (but accrued since 1 July 2005) by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is resident of Luxembourg, may be subject to a withholding tax of 10 per cent.

The quasi-general absence of withholding tax on interest makes Luxembourg the preferred jurisdiction for international acquisition finance transactions.

If an investor wants to fund the acquisition as far as possible with debt, Luxembourg tax law is 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 (participating interest) by intragroup loans. In such a situation, the tax authorities generally consider a ratio of 85/15 as being in line with the arm's-length principle, which means that 85 per cent of the purchase price of the participating interest that is being acquired may be financed by an intragroup loan. A debt-to-equity ratio of 99/1 could also be achieved by the use of interest-free loans from shareholders (which may be treated as equity for corporate income tax purposes). Such a funding structure should be analysed on a case-by-case basis.

Interest rates must not exceed market rates. Any excess interest payments that result from an excess over the aforementioned debt-to-equity ratio would be reclassified as hidden profit distribution, subject to withholding tax at a rate of 15 per cent, generally applicable to dividends payments.

Gross-up provisions are common in lending documentation and a 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?

There is a rule of public policy that forbids usury. Article 494 of the Luxembourg Penal Code provides that whoever, by abusing of borrower's weaknesses, obtains a rate exceeding the legal interest can be sentenced to imprisonment of one month to one year and pay fines ranging from €500 to €25,000, or either ones of these penalties. Furthermore, If the lender voluntary abuses of the borrower's need or inexperience to get an interest clearly exceeding the normal interest 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 *anatocisme*). The principle of *anatocisme* (governed by article 1154 of the Luxembourg Civil Code) is limiting the frequency at which interest can be compounded on interests: interest can only be compounded once a year, provided such interest charge 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 an 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 would tend to favour the lenders. Provisions in

agreements would 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 issued initially to underwriters or initial purchasers are not indemnified by the issuers thereof, 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?

Claims (including claims for interests) 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 that govern whether an entity can act as an administrative agent for a bank financing.

The law of 10 August 1915 on commercial companies, as amended (the Company Law), provides the appointment of a fiduciary agent (some equivalent to trustee) in certain types of companies such as the public companies limited by shares which have issued bonds. Such 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 provides also 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 HCCH Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trusts Convention). Although there is no possibility to create a trust within the meaning of Anglo-Saxon trust 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 introduced, under Luxembourg law, 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 (no registration or publication requirements) and is effective towards third parties upon its execution, without further notification requirements. An assignment of claim to a trust is enforceable against third parties upon its execution.

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

Borrowers may, from time to time, buy back debts. However, although legal provisions regulate and organise the redemption of shares, no legal provisions govern debt buy-back. Buy-backs are a matter for contract negotiations. Junior and senior debts have been bought back heavily in recent years, with the view to benefiting 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 ensuring 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; however, under the indenture affiliates are typically not permitted to vote for 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, 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 financings. 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 either fixed 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, changes consented to that amend the securities features should not be so substantial 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 liability charges over a guarantee. No stamp duty or similar tax or charge applies to the creation or enforcement of a specific security interest over moveable assets such as shares, bank accounts or receivables; nor are there any public registration requirements.

Registration at the mortgage registry 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 as a 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 would be entered into by way of a notarial deed filing 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 per cent to 4 per cent.
- €3,800 to €10,000: 0.15 per cent to 1.5 per cent
- €10,000 to €50,000: 0.1 per cent to 0.6 per cent.
- €50,000 to €100,000: 0.025 per cent to 0.5 per cent.
- €100,000 to €990,000: 0.01 per cent to 0.1 per cent.
- €990,000 to €1.25 million: 0.01 per cent to 0.05 per cent

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

In the event of enforcements or proceedings before Luxembourg courts or presentation of security documents – either directly or by way of reference – to an *autorité constituée*, such court or *autorité constituée* may require registration of all or part of the security documents with the registration administration in Luxembourg, which may result in registration duties at a fixed rate of €12 or an ad valorem rate (which depends on the nature of the registered document) becoming due and payable, but which generally could amount to 0.24 per cent of the amount of the total indebtedness to be secured by the security contract.

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 incorporated in the form of a *société anonyme* (public company limited by shares and for companies generally governed by rules applicable to *sociétés anonymes*) 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 49-6 of the Luxembourg companies law provides that a *société anonyme* 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.

Given the general language used in the Law, the provisions of article 49-6 of the Luxembourg companies law are interpreted widely such that:

- the prohibition applies irrespective of whether the financial assistance is granted by the target directly to the acquirer or indirectly, through an affiliate of the acquirer or a third party acting for the acquirer (such as a fiduciary);
- the prohibition applies whether the target provides assistance by means of a loan, of an advance which does not necessarily qualify as a loan or through the granting of security; and
- it does not matter whether the relevant financial assistance is given before or after the acquisition, provided that there is a link between the assistance and the acquisition of the shares;

There are a number of 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 was introduced into the law intended to facilitate the restructuring of the shareholding of *sociétés anonymes*, while still protecting the interests of minority shareholders and creditors.

The whitewash procedure requires:

- the management body to assess the corporate interest of the company, the consideration (which must be on arm's-length terms) to be received by the company and the financial situation of the acquirer and other third parties involved in the transaction;
- the management body to prepare a report explaining the purpose and benefits of the transaction for the company, the risks for the company and the price the acquirer proposes to pay for the shares in the company;
- the report described above to be filed with the Luxembourg Registry of Trade and Companies and published in the Luxembourg Official Gazette within certain deadlines;
- the general meeting of shareholders to approve the transaction based on the above report (which approval requires a decision by at least two thirds of votes cast at a meeting of shareholders representing at least half of the corporate capital of the company); and
- the company having non-distributable reserves at least equal to the value of the financial assistance granted.

Article 49-6bis 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 that the whitewash procedure is still relatively new for the Luxembourg market, it is not yet clear whether market participants will embrace it or whether they will prefer to continue to structure transactions in order to avoid the general financial assistance prohibitions.

There may also be limitations where cross-group guarantees or upstream guarantees by subsidiaries of the borrower are being granted. Luxembourg does not recognise the concept of 'group of companies' and the interest of the corporate group is not sufficient to justify and validate an upstream guarantee. Corporate benefit must be scrutinised case by case: the guarantor should have some personal interests in the guarantee, notably through its expected benefits, and the risks he would take should be commensurate with the benefit deriving therefrom. In addition, the financial exposure deriving from the guarantees should not exceed the financial means of the guarantor, and in particular should not induce the guarantor, if the guarantee is called, 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 mortgages over land, buildings and vessels; and
- securities over moveable assets, which include:
 - securities over financial instruments (pledge over shares, claims, bank accounts, debt instruments, assignment of title by way of security), which is governed by the law of 5 August 2005 on financial collateral (the Financial Collateral Law);
 - pledges over goods or tangible assets which 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 stocks of the company);
- preservation of title on tangible assets; and
- retention rights under a sale contract 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, common in international transactions that a Luxembourg company grants a fixed or floating charge governed by foreign law (for further information about enforceability, please see question 1).

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

17 What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Perfection requirements depend on the type of asset subject to the security. Security interests over immovable assets or business assets will have to be registered with the local mortgage registration office. For other type of assets, perfection will generally occur by means of a notification to a third party (eg, pledge over claims), registration in private records (eg, pledge over shares) or delivery of certain assets (eg, pledge over goods).

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

In general, no procedure is required. Security agreements generally provide that the security interest is continuing and will remain valid until full settlement of the secured obligations.

However, a pledge over business assets is only valid for 10 years (but is renewable).

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

No, there is no consent of a 'works council' required.

It is recommended to ensure that the granting of guarantees or 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 interests 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, acting for itself and for the benefit of all lenders.

For other type of securities, 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.

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 incurrance of debt or the grant of a security interest in collateral in connection therewith could be voided under certain conditions. Please see question 31.

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 of the cases, debt commitments are governed by foreign laws. Legal techniques and the sequence of documentation prevailing in the 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, an acquisition finance document will customarily include a letter of intent, a commitment letter issued by the bank or financing parties, 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 which would comprise a 'security package', including pledge over receivables, pledge over shares and other charges on moveable 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 to the extent this type of general security is unlikely to be enforceable under Luxembourg law.

Except for a commitment letter and letter of intent, the documentation is contemporaneously signed on the day of the closing with the acquisition. Signing in counterparts has now become a common practice in Luxembourg and exchange of executed documentation by fax is validly recognised. Luxembourg civil law requires however, that agreements be signed in such number of originals as the number of parties to the agreements who have a distinct interest 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 both its 'tax-appeal' and ease of public quotation and pragmatic contractual enforcement, parties resort to the Luxembourg jurisdictions when the deal is nearly completed and all financing details have been sorted out. With closing occurring when financing is secured,

it is therefore infrequent to negotiate a transaction in Luxembourg whose financing remains uncertain.

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:

- legal and financing due diligence (including audited and unaudited financial statements and pro forma financial statements);
- review of good standing of corporate borrower;
- report on title (real estate);
- tax clearance on the acquisition structure and structure memorandum;
- corporate CPs: existence, authorisation, capacity to enter into the contractual documentation, including directors' or managers' certificates, and in some recent cases solvency certificates issued by the CFO of borrowers;
- a funds flow statement;
- legal opinions from counsel on the borrower or target;
- no business material adverse change (MAC);
- 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 and 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 banks or UK banks, or UK branches of French and German financial institutions. Each of them tend to deal according to their national market practices.

Flex provisions have been increasingly predominant in the post-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 included pricing flex at levels substantially higher than expected market-clearing prices, and imposed additional adjustments for changes in market indices. Other provisions include excess cash flow sweep (an increase in percentage subject to sweep) or an increase in financing ceilings.

Some observers have also commented 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 would have the right to require from a borrower to replace the bridge loan with a permanent financing package. Bridge financing would ordinarily finance initial capex investments. The issuance of free warrants for acquiring equity interests or other debt-equity instruments that have tax hybrid characteristics, thus allowing tax deductions in target countries and exemptions on income in the lender's jurisdictions, would also frequently secure bridge financing. Pre-closing, a demand for securities to be put in escrow before financing is rare due to the legal constraints in corporate law on the ease to proceed to the issuance of securities in advance or on demand.

Tax-driven instruments would be the most popular securities for optimising the tax efficiency of the transaction. These techniques are generally mostly adopted by private equity houses in deal acquisition. The terms and conditions of the securities would generally 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 versus non-secured, 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 wish to ascertain that most of the contractual provisions protecting their rights, subject to foreign law, will be fully enforceable in Luxembourg against the Luxembourg SPV. Much care would be taken to address representations relating to valid corporate authority and the binding effects of 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. The validity and enforceability of non-recourse clauses, upstream guarantees or subordination provisions will be heavily scrutinised and security packages would be drastically negotiated. In particular, provisions ensuring the enforcement of loan agreements in distressed situations would be a key in the Luxembourg negotiations with a view to enable lenders to recover their investments in insolvency situations.

In addition, lenders will be sensitive to any tax issues that the use of a Luxembourg SPV could generate. Specific representations and covenants will be negotiated to this effect and an assurance that the tax treatment of 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 the best place in the world to enforce collateral (World Bank report). The law is very flexible in this respect and the Law on Financial Collateral 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 notwithstanding the filing of the petition for bankruptcy or other collective proceeding, whether occurring in Luxembourg or abroad.

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

31 Discuss any preference periods in which secured claims could be voidable.

As a matter of principle, rights granted by a Luxembourg company during the 'crystallisation period' (ie, the period starting on the day a Luxembourg company becomes insolvent (such date is usually set by the Luxembourg courts six months prior to the insolvency judgement)) or in the 10 days preceding this crystallisation period may be declared invalid if they constitute the preferential satisfaction of one creditor over another.

The following transactions must be declared null if they were undertaken during this period:

- a disposal of assets without consideration or for a value which is not at arm's length;
- any payment (whether in cash, assignment, sale or set-off) for a debt not due for payment;
- payment of debts due by any means other than in cash or bill of exchange; and
- mortgages or pledges granted to secure pre-existing debt (except for pledges granted over financial instruments, as mentioned in question 30).

In addition, any payment for accrued debt or any transactions against money made after the company has become insolvent and prior to the bankruptcy judgment may be cancelled if the beneficiary of the payment or the contracting party had knowledge of the insolvency of such company.

Mortgages and other rights of priority validly acquired during the crystallisation period and the 10 days preceding such period can be declared void if they were not registered within 15 days of their execution with the relevant Luxembourg authorities.

Eventually, any instruments or payments made fraudulently and without regard to the creditors' rights are void without prejudice to the date they were made.

As mentioned under question 30, securities granted pursuant to the Financial Collateral Law remain unaffected by the insolvency situation; as a consequence the crystallisation period principle does not apply to these securities.

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

There is no equivalent concept under Luxembourg law.

33 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 collection of claims against the bankrupt entity. Secured creditors benefiting from certain type of securities (eg, a 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.

34 In the course of an insolvency, can previous payments to lenders be clawed back by a court or other authority? What are the rules for such clawbacks and what period is covered?

Please refer to question 31.

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

Secured creditors benefiting from valid securities shall be 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:

- court costs, including the fees of the trustee or receiver, appointed by the court;
- compensation for victims of an accident, funeral costs;
- unpaid wages or salaries of employees of the insolvent company.
- tax and social security claims;
- specific privileges on moveable assets (as opposed to general privileges, specific privileges can only be enforced on specific assets of the debtor, for example, rents can be secured by the furniture of the rented premises);
- general privileges on moveable 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 '*prior tempore, potior jure*' rule 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 has been 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.

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

Although there is no specific case law on the validity of contractual subordination agreements, the practice recognises their validity. There exists, under Luxembourg law, no legal provision preventing creditors to agree on the rank of their claims. Such agreements are effective towards third parties and courts would normally enforce them.

37 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 as of the date on which the bankruptcy has been declared, except when the debt is subject to a security. The discount on securities corresponds to interest that has not accrued and has not unexpired.

38 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. As the security is generally in rem, all liabilities follow the collateral.

VANDENBULKE
CORPORATE, FINANCE AND TAX LAWYERS

Denis Van den Bulke
Laurence Jacques

dv@vdbl.com
lj@vdbl.com

35 Avenue Monterey
2163 Luxembourg
Luxembourg

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



GETTING THE DEAL THROUGH

Annual volumes published on:

Air Transport	Licensing
Anti-Corruption Regulation	Life Sciences
Anti-Money Laundering	Mediation
Arbitration	Merger Control
Asset Recovery	Mergers & Acquisitions
Banking Regulation	Mining
Cartel Regulation	Oil Regulation
Climate Regulation	Patents
Construction	Pharmaceutical Antitrust
Copyright	Private Antitrust Litigation
Corporate Governance	Private Client
Corporate Immigration	Private Equity
Data Protection	Product Liability
Dispute Resolution	Product Recall
Dominance	Project Finance
e-Commerce	Public Procurement
Electricity Regulation	Real Estate
Enforcement of Foreign Judgments	Restructuring & Insolvency
Environment	Right of Publicity
Foreign Investment Review	Securities Finance
Franchise	Shipbuilding
Gas Regulation	Shipping
Insurance & Reinsurance	Tax on Inbound Investment
Intellectual Property & Antitrust	Telecoms and Media
Labour & Employment	Trade & Customs
	Trademarks
	Vertical Agreements



For more information or to purchase books, please visit:
www.GettingTheDealThrough.com



Strategic research partners of
the ABA International section



THE QUEEN'S AWARDS
FOR ENTERPRISE:
2012



The Official Research Partner of
the International Bar Association