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Acquisition Finance

Luxembourg
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Law and Practice

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1. MARKET

1.1 Major Lender-Side Players

The Luxembourg market is particular in the sense that international groups as well as investors have chosen Luxembourg as a European financial centre specialising in serving international clients and investors. Luxembourg's sense of innovation has made it an important jurisdiction for start-ups becoming the target of acquisitions.

Luxembourg is also a prime jurisdiction for debt, credit and opportunities funds and other major players in acquisition financing. The market for sustainable finance has further developed rapidly in Luxembourg.

Luxembourg corporate structures in international acquisitions are therefore very common, generally for reasons of innovation, efficient structuring, corporate law and the availability of specialised vehicles, as well as stability and the local know-how regarding holding structures, international financing transactions and investment funds. Other reasons for the importance of international acquisition financing in Luxembourg are the efficiency of the available collateral package and the Luxembourg stock exchange/ Euro MTF in respect of debt capital.

As a result, the major players active in the Luxembourg lending market are truly international and include international banks, Luxembourg and foreign debt or credit funds, and more and more local banks or lending vehicles.

1.2 Corporates and LBOs

Similar to the very international character of the major players on the lending side, a mixture of international corporate financing and leverage acquisition financing is implemented through Luxembourg.

1.3 COVID-19 Considerations

The first months of the COVID-19 pandemic saw a slow down for some sectors, with great nervousness on both the borrower and lender sides. Multiple borrowers sought to obtain additional financing commitments to cover future expected liquidity needs due to the lockdowns in multiple jurisdictions, while lenders requested additional securities for certain asset classes. Since then, the market has again grown significantly.

During the first months of the pandemic, the transaction timelines of already initiated deals (and the related financings) were significantly shortened in order to reduce the implementation risks. In the second half of 2020, the acquisition market adapted to the new situation, and new deals in need of financing once again became more frequent. While the timelines remained very ambitious, however, the pace again decreased somewhat.

The Luxembourg government reacted very quickly and took various measures to adjust the legal corporate requirements for companies and thereby facilitate the process.

The COVID-19 pandemic had a certain albeit limited impact on documentation, with certain credit agreements excluding the pandemic as force majeure and a new type of risk factor appearing in offering memoranda.

2. DOCUMENTATION

2.1 Governing Law

The finance documents (other than security documents) reflect the international character of the financial market and the flexibility of Luxembourg contract law, and are more often than not governed by foreign law, predominantly English and US law. More recently, however, Luxembourg law has been used more frequently as the

governing law of the main finance documents, due to a certain shift to the continent, the uncertainties linked to the UK's departure from the European Union and an increase in acquisition financing activity among Luxembourg lenders.

In respect of security, among other matters, Luxembourg follows the lex rei sitae rule so the law governing the security documents will largely depend on the jurisdiction of the relevant asset. Luxembourg assets will typically be subject to Luxembourg law security. With the rapidly developing fund financing sector where the main fund-side actors are located in Luxembourg and security is granted over capital commitments or depositary accounts, an increasing amount of financing-related documentation is subject to Luxembourg law.

2.2 Use of LMAs or Other Standard Loans

Facility agreements are mostly based on Loan Market Association (LMA) or Loan Syndication and Trading Association (LSTA) standard loan agreements, and typically contain the terms and conditions that are considered market practice in the major jurisdictions and other financial centres. Facilities governed by Luxembourg law will often also follow or be similar to the standard LMA or, less frequently, LSTA arrangements.

2.3 Language

Given its international character, finance documentation is typically drafted in English, with some exceptions of French or German. There is no language requirement in Luxembourg, and the international market largely favours the English language.

2.4 Opinions

The provision of legal opinions is part of the international market practice and a given in acquisition financing. Luxembourg market practice generally follows the practice of the jurisdiction of the governing law as to the legal adviser giving the opinion, and therefore legal opinions are given by lender counsel, borrower counsel or both, with varying scopes. Legal opinions generally cover the full range of customary opinions, such as validity, legality, enforceability, existence, capacity and authority, governing law and jurisdiction, non-conflict, etc.

3. STRUCTURES

3.1 Senior Loans

Acquisition structures generally involve one or several layers of Luxembourg companies, depending on circumstances such as whether, in addition to a management participation, there is an institutional co-investment or a seller rollover, whether there is a multi-layer financing requiring structural subordination or providing for a high-yield notes offering, or whether there is a need or desire to separate the borrower group from the rest of the group.

Certain sponsors also favour a "master" or "super" holdco structure, whereby the deal-specific acquisition structures are set up as "silos" under a global Luxembourg hub. Similar structures, with acquisition "silos", are common if the relevant sponsor fund is located in Luxembourg.

A typical acquisition structure consists of a Luxembourg-based parent company at the top of the acquisition structure, which serves as a holding/sponsor and management company, or possibly a joint venture vehicle. Certain players prefer to invest in the top holding company through their own dedicated Luxembourg-based holding company and give the opportunity to management and/or co-investors, for example, to invest through a pooling or aggregator vehicle in the top holding company. Below the parent company, one or more intermediate holding companies are set up to accommodate the debt

financing and possibly the security structure. In acquisition structures, one would commonly see one or more non-regulated entities below the relevant fund, sponsor or corporate.

Among other things, Luxembourg acquisition structures allow flexibility in providing investor funding to the acquisition company. Such funding is granted partly in the form of pure equity (share capital and premium) and partly in the form of debt.

The third party debt portion takes various forms and ranges from senior loans, mezzanine loans, first and second lien, and PIK loans to debt securities, covering everything in between; it depends entirely on the financing needs, the market conditions and the availability of certain sources of financing. It is more common than not to have a mixture of debt made up of any of the above. Equity kicker rights granted to certain mezzanine lenders (regularly debt funds) are also sometimes used, allowing them to obtain a participation in the equity of the structure.

Senior Loans

Senior loans are generally part of acquisition financing. In a first instance, they are normally granted by one or more major international banks or loan originating funds (often based in Luxembourg). As part of syndication or later transfers or participations, other lending players such as debt or loan funds will hold part of the debt.

3.2 Mezzanine/PIK Loans

Although lending to the public is a regulated activity in Luxembourg, there are structures where funding is provided not only in the form of "pure" loans – be they senior, subordinated or bridge – but also with an investment element, sometimes linked to the equity. Such financings bear a higher risk as they are often unsecured or benefit only from limited recourse or lower ranking security, and are subordinated either contractually or for part of the funding through the form of the funding, namely the equity element. The higher risk calls for a higher reward, of course, and higher interest rates apply. Furthermore, the equity element allows a direct or indirect sharing in the profits or a participation in the secondary offering – for example, in the event of an IPO of the relevant company.

Mezzanine financing, although still provided for by banks, also attracts more specialised "lenders" – ie, funds or other investment vehicles that intend to make an "investment" rather than proceeding to a pure lending. Such funds or investment vehicles are often based in Luxembourg and/or for various reasons propose to structure their mezzanine financings through special purpose companies. The provision of such "financing" in Luxembourg by entities other than banks or other authorised entities may raise the issue of whether such financing would qualify as a lending activity and thus be prohibited for non-regulated entities.

Mezzanine investment activity is generally different from a "pure" lending or banking activity for a number of reasons. Where a Luxembourg special purpose vehicle is used by mezzanine lenders, such company does not normally itself appear to the public as offering its services as a lender. Furthermore, it is often not possible to separate the debt side from the equity side. Such investments are generally structured as debt in order to provide adequate rights to the lender (namely, creditor rights) but economically also present equity characteristics. In terms of ranking, the mezzanine lender is closer to the shareholder than an ordinary lender, and his return is generally enhanced either by elements of in-kind reimbursements (PIK) or by the issue of warrants or similar equity exposed securities. On that basis, mezzanine structures using Luxembourg special purpose vehicles normally

fall outside the scope of the regulated financial activities.

3.3 Bridge Loans

Bridge loans are commonly used, either if the financing set up includes debt securities to be issued at a later stage or to bridge the gap between the time when the funding is needed and the time that the acquiring fund expects to receive the money from investors. Funds often use bridge loans to be able to react quickly to investment opportunities, to reduce the number of capital calls, to be able to determine the exact amount of the capital call, and to have better control and visibility over the timing of the capital call.

3.4 Bonds/High-Yield Bonds

The issue of high-yield or other debt instruments is a method of financing that goes through cycles and the use thereof in acquisition financing depends on the market. The bonds are generally issued under English or US law. Luxembourg company law expressly permits the issue of bonds by a Luxembourg company under a law other than Luxembourg law, and stipulates that in that case provisions of Luxembourg law relating in particular to bondholder representation and meetings can be expressly disapplied. Luxembourg law has recently added additional flexibility by extending the possibility to issue bonds (publicly or not) to additional forms of companies, thereby adjusting to a need in the market.

3.5 Private Placements/Loan Notes

Debt securities used in Luxembourg acquisition financings are commonly issued under the private placement exemptions. Loan notes are generally vendor loan notes.

3.6 Asset-Based Financing

Given the size of the country and the few industrial activities present in Luxembourg, the acquisition of assets located in Luxembourg is fairly rare compared to the acquisition of assets located abroad, which are funded by using corporate structures involving Luxembourg entities. That being said, the structures used for asset-based financings do not materially change from other acquisition financing structures.

4. INTERCREDITOR AGREEMENTS

4.1 Typical Elements

Intercreditor agreements and subordination agreements are entered into in almost all international acquisition financing transactions in Luxembourg, and are generally not governed by Luxembourg law.

Typically, intercreditor arrangements applicable in Luxembourg acquisition finance structures regulate the respective rights of the finance parties as well as those of the intragroup lenders and shareholders, including ranking and priority, the receipt of payments, the effect of events of default, enforcement, sharing, debt acquisition, and redistribution. They also regularly include the security agent appointment and terms.

In large-scale financing transactions with multiple layers of debt, different intercreditor agreements are sometimes entered into between the different finance parties and frameworked by a master intercreditor agreement.

4.2 Bank/Bond Deals

Master intercreditor agreements are used more and more often in bank/bond financings.

4.3 Role of Hedge Counterparties

Intercreditor agreements generally provide for a senior ranking claim of the hedge counterparties (and thus scheduled payments to the hedge counterparties are permitted), but the conditions

to close out hedging transactions are subject to restrictions.

5. SECURITY

5.1 Types of Security Commonly Used

Luxembourg companies in acquisition structures are commonly holding or finance companies whose main assets consist of the holding of participations, intercompany receivables and assets on bank accounts. The form of security interest depends largely on the location of the assets. In addition, Luxembourg companies also regularly hold intellectual property rights and real estate. The most common forms of security are pledges, assignments and transfers by way of guarantee (and, with respect to real estate, mortgages).

Luxembourg law permits the implementation of a very secure and efficient security package as regards assets located (or deemed to be located) in Luxembourg.

The first category of securities covers financial collateral arrangements. The law of 5 August 2005 on financial collateral agreements, as amended (the Financial Collateral Law), provides for a robust framework where financial collateral arrangements are largely excluded from the scope of bankruptcy. The Financial Collateral Law provides for the following types of financial collateral:

- transfer of ownership by way of security interest (*transfert de propriété à titre de garantie*);
- repurchase agreement (*mise en pension*); and
- pledge over collateral (assets) (*gage sur avoirs*).

The pledge of assets is the most common collateral in acquisition finance. "Collateral" means financial instruments and claims, and the Financial Collateral Law expressly provides that "financial instruments" shall have the "broadest possible meaning", and includes a non-exhaustive list of different types of financial instrument. This is particularly relevant in respect of new types of assets, such as tokens or smart contracts, and the analysis as to whether they may be qualified as "financial instruments" under the Financial Collateral Law. However, the assets generally subject to pledges in acquisition financing transactions remain shares (or other equity or similar securities), loans and bank accounts and more recently also pledges over capital commitments in partnerships (which fall under the qualification of claims under the Financial Collateral Law) in the context of fund financings.

The Luxembourg financial collateral pledge has certain appealing features, which make it a useful tool in finance structures, including the following:

- confidentiality – the pledge agreements are created under private seal and are not subject to registration with public authorities or publications;
- an extended scope, including shares, bonds, debt instruments, loan notes, claims, whether existing at the time the pledge is put in place or coming into existence thereafter, and any related assets;
- straightforward and cost-efficient perfection requirements;
- the possibility of different ranking pledges;
- the possibility to agree on the exercise of voting or other rights;
- no hardening period – security for prior debt is possible;
- no requirement of prior notice in the case of enforcement, as once duly perfected the assets are deemed to be "in possession" of the pledgee or a third party agreed on by the parties; and

- validity, even in case of the bankruptcy or insolvency of the pledgor.

Shares

Pledges over shares (including future shares and related assets) and equity instruments are very common in Luxembourg. The company over whose shares a pledge is granted is commonly made a party to the pledge agreement. The agreement will regulate the exercise of voting and other rights and the rights to distribution. In addition, the parties would normally agree on the appropriation of the shares in the case of enforcement, and on the related valuation methodology required by law. Pledges over other types of equity (eg, beneficiary certificates, warrants) or debt securities largely follow the rules applicable to share pledges.

Bank Accounts

Pledges can be taken over cash or securities accounts located in Luxembourg. Accounts can be operated freely even when pledged, or can be blocked accounts depending on the terms of the pledge agreement. In order to permit a first ranking pledge, the account bank will be asked to waive its prior lien on the account and to acknowledge the pledge. Depending on the type of financing structure, signature powers over the relevant accounts can be regulated in the pledge agreement.

Receivables

Receivables are either made subject to a pledge or assigned. The development of fund financings in Luxembourg has increased the scope of receivable pledges through the addition of security over capital commitments.

The second category of securities consists of agreements over movable assets, which are not considered as financial collateral arrangements.

Other Movable Assets

In finance acquisition transactions, securities over movable properties other than financial instruments or claims are more unusual. If such security is taken, it would normally take the form of a commercial pledge (*gage commercial*) and would be governed by the Luxembourg Commercial Code. However, certain movable assets – such as aircrafts and ships weighing more than 20 tonnes – must be secured by a specific mortgage.

Inventory

Pledges on inventories are quite unusual in Luxembourg, given that the pledgee must hold a special authorisation and the pledges are subject to restrictions.

IP Rights

Pledges over IP rights can be made in relation to the following in particular:

- patents (*brevets*);
- trade marks (*marques*);
- designs (*dessins et modèles*); and
- copyrights (*droits d'auteur*).

A pledge over patents must be registered with the Patent Registry of the National Intellectual Property Services, and a pledge over trade marks and designs must be registered with the Benelux Office of Intellectual Property. Other pledges over IP rights are generally governed by private agreements only.

The third category of securities covers immovable assets and, in particular, real estate.

Real Estate

The principal security granted over real estate is the mortgage (*hypothèque*), which takes the form of a notarial deed and must be registered with both the Administration Registry (*administration de l'enregistrement et des domaines*) and

the Mortgage Registry (*bureau de conservation des hypothèques*). The registration of the mortgage is subject to a registration fee, and must be renewed every ten years in order to remain enforceable against third parties.

5.2 Form Requirements

The most commonly used security in acquisition finance – the financial collateral subject to the Financial Collateral Law – is not subject to stringent form requirements. The Financial Collateral Law provides that financial collateral arrangements and netting agreements may be evidenced among the parties and vis-à-vis third parties in writing or by any other legally equivalent manner, as determined by the Commercial Code.

The Financial Collateral Law further provides, inter alia, that the provision of collateral – ie, the delivery, transfer, holding, registration or otherwise granting of possession or control over the collateral asset – must be capable of being evidenced in writing. The written instrument evidencing the provision of collateral, which may be in electronic format or any other durable medium, must allow the identification of the collateral to which it applies. With regard to book entry financial instruments and cash claims collateral, it is sufficient to prove that they have been credited to, or form a credit in, a designated account.

5.3 Registration Process

There is no general registration requirement for securities and there is no general securities register. The perfection requirements depend on the type of asset (and sometimes the type of security).

For pledges under the Financial Collateral Law, the following perfection requirements need to be observed, depending on the type of collateral being pledged.

Shares and Other Types of Securities (Beneficiary Certificates, Notes, Bonds)

Perfection is made through the inscription in the register of the relevant securities of the pledged company (for shares and other securities in registered form) or the register of the depository (securities in bearer form to the extent deposited). The pledged company is typically (but not necessarily) a party to the pledge agreement; otherwise the pledge is notified to the company.

Bank Accounts

In order to permit a first ranking pledge, the account bank will generally be asked to waive its prior lien on the account or to accept that it is downgraded in ranking and to acknowledge and accept the pledge after it has been notified to it or, when it is a party to the agreement, in the agreement itself.

Book Entry Financial Instruments

The pledge is perfected by one of the following:

- the simple conclusion of the pledge agreement if the custodian is the pledgee;
- the conclusion of the pledge agreement if the pledgee is a third party and the custodian is a party thereto, or the notification of such agreement to the custodian if it is not a party to the agreement;
- a book entry registration to an account of the pledgee; or
- a book entry registration to a third party account.

Receivables

Security over intercompany receivables is generally perfected (through the notification of the security or by making the debtor a party to the agreement), while security over receivables due from third parties is not always perfected, but this has an impact on its enforceability and ranking.

Customarily, the security agreements will cover any additional and future collateral entering into the possession of the grantor of the security. If additional instruments are acquired by the pledger, the inscription of the pledge will be updated.

Securities over IP rights, aircrafts, ships over a certain tonnage, inventories and real estate are each subject to their own registration requirements (see **5.1 Types of Security Commonly Used**).

5.4 Restrictions on Upstream Security

A Luxembourg company must act within the limits of the corporate object specified in its articles of association, and in its corporate interest (see **5.6 Other Restrictions**). As a general rule, companies cannot simply encumber their assets or grant guarantees (or security) in favour of third parties (including group companies) without this being in their corporate interest. Upstream security (or guarantees) must therefore be within the company's corporate object, and a corporate interest analysis (which is a factual analysis) must be made by the board of the company. To the extent the articles permit such security or guarantees and the transaction is determined to be in the corporate interest of the company, a Luxembourg company may grant security and guarantees for the benefit of group companies (including upstream or cross-stream security). Subject to certain conditions (see **5.6 Other Restrictions**), the group interest may also be taken into account.

5.5 Financial Assistance

The financial assistance rules apply particularly in relation to the purchase of shares (and instruments convertible into shares) of joint stock companies (*société anonyme* and *société anonyme simplifiée*) and corporate partnerships limited by shares (*société en commandite par actions*). These companies can only provide financial assistance directly or indirectly (advance funds, make loans, grant security and provide guarantees) for the purpose of the acquisition of their shares by a third party, subject to stringent conditions – ie, subject to a so-called whitewash procedure. Transactions concluded by banks and other financial institutions in the normal course of business or transactions effected with a view to the acquisition of shares by or for the staff of the company or certain group companies are not subject to such conditions, with the exception of the net asset test condition.

Financial assistance may be provided under the responsibility of the board of directors on the following conditions:

- fair market conditions (particularly regarding interest received by, and security provided to, the company);
- the interest of the company;
- an investigation of the credit standing of the relevant third party;
- a submission to the general meeting of shareholders of a report by the board of directors covering, inter alia, the reasons for the transaction, the interests of the company, the conditions, the liquidity and solvency risks, and the price at which third parties are willing to acquire the shares. Such report must also be filed with the register of commerce and companies, and will be published;
- the approval by the general meeting of shareholders at qualified majority; and
- the net assets test: the financial assistance provided is considered as if it were a distribution and therefore must not cause the net assets of the company to fall below the share capital and non-distributable reserves of the company. Among the liabilities in the balance sheet, the company shall include a reserve, unavailable for distribution, of the amount of the aggregate financial assistance.

5.6 Other Restrictions

There are certain other conditions that need to be satisfied when a Luxembourg company is granting security or giving guarantees. The rules governing these restrictions stem from general principles of law and must be applied on a case-by-case basis to the specific circumstances. The conditions to be satisfied relate to corporate power, corporate authority and corporate benefit.

Corporate Power

Limits on corporate power can be imposed either by law or by the articles of incorporation of the company.

Limits on corporate power imposed by law

In the past, the question has arisen of whether a Luxembourg company may grant security or give guarantees in respect of debts or obligations of its parent company or a sister company, without any monetary consideration (namely, no commission). The reason for the debate lies in the concept of the Luxembourg Civil Code, pursuant to which a company is established with a view to participating in the profits (and losses) that may arise therefrom. A purely free (or gratuitous) act, without consideration, is therefore outside the limits of commercial law, given that the goal to share the profits is an essential element of every company.

Nowadays, both doctrine and case law give an extensive interpretation to the principle of profit participation, and agree that the search for profit can be direct or indirect. As a result, a company may carry out acts for which it does not receive a monetary consideration to the extent its actions are in furtherance of its object. In respect of intragroup guarantees and security, authors generally conclude that “except in exceptional circumstances, an intragroup security is a type of act which may serve the purpose of realising a profit.”

It is therefore only in exceptional cases when the circumstances do not reasonably allow justification, even indirectly, of a potential benefit of, or a motivated interest for, the proposed guarantee or security for a company that the validity thereof could be challenged and/or the liability of directors could be invoked.

Limits on corporate power imposed by the articles of incorporation

The corporate power of a company is determined by its articles of incorporation. The purpose of the object clause is to set the framework within which the management is authorised and instructed to develop and manage the affairs of the company.

Object clauses of a Luxembourg company are normally more specific than those one would traditionally find in Anglo-Saxon jurisdictions. Typically, Luxembourg companies that are part of an acquisition structure will have a financial participation company object (ie, objects limited to holding and managing participations in other companies in Luxembourg or abroad). In order to provide guarantees or security, the wording of the object clause should specifically address this possibility (including upstream or cross-stream guarantees or security).

If the provision of a guarantee or security by a Luxembourg company would be considered to exceed the corporate object provided under the articles of incorporation, the company is most likely still bound by the relevant transaction, even if such transaction is ultra vires; however, its management may be held liable. The relevant provision in Luxembourg corporate law, which is derived from the first company law directive, has the merit of protecting lenders acting in good faith. The company could not at a later stage claim the annulment of the loan or the guarantee that exceeded the corporate object. However, the reverse is also true, and the lenders similarly

could not achieve the result of the loan being declared null and void.

However, the protection is only granted to good faith lenders. Luxembourg authors have pointed out that, where legal opinions contain assumptions or qualifications in relation to this aspect, a bank might be considered to have been aware of the breach of the object clause and, as a consequence, the company could claim that the guarantee or security is null and void. Although this could be the case for a specific qualification in a legal opinion, the solution should not be the same in the presence of an assumption, in which case the lawyer "assumes" a fact he has not verified without expressing any view on it. Furthermore, in light of the extended review of the target's group, which is generally made by the lenders and their advisers, particularly through legal due diligence, it may prove difficult to convince a judge that the lenders had no knowledge of the ultra vires issue.

Corporate Authority

Decisions on the granting of guarantees or security are within the competence (and under the responsibility) of the board of directors. The board shall take its decision on the basis of all relevant elements needed for the board members to make an informed judgement – in particular the amount and terms of the borrowing or the guarantee, including details of interest rates, reimbursement dates and options, specific representations and warranties, negative pledges, covenants, and the effect of their decision on the financial capacity of the company. The analysis of these elements by the board will be of utmost importance, particularly in the discussions on the corporate benefit. Practice shows that the board often approves the principles of the transaction on the basis of the main terms and conditions, and grants power to a committee or to one or more directors to finalise documents in the negotiations, to make appropriate amendments where necessary, and to later execute the contracts in the name and on behalf of the company.

Corporate Benefit

A Luxembourg company must always act in its corporate interest. Therefore, the granting of security and guarantees is also subject to the existence of the company's corporate interest in providing these and, according to certain authors and also some case law, their validity may depend thereon.

"Corporate interest" when used herein is used as a translation of the French concept "*intérêt social*".

"Corporate interest" is not defined by law as such; the concept has been developed by doctrine and court precedents. It is (in our view) best described as being "the limit of acceptable corporate behaviour". Different interpretations have been given to the term "corporate interest", whereby the broad interpretation that prevails is based on the institutional theory of the company and concludes that the interest of the company is more than the interest of the shareholders but is the interest of the company in itself as a legal entity and all its stakeholders – ie, the entire collectivity gathered around the company, comprising the company itself and its shareholders but also its creditors, bankers and workforce.

The corporate interest analysis is a factual analysis and is specific to the company and the circumstances. In acquisition financing, when considering the corporate interest of a company, the concept of a group of companies becomes very relevant, particularly in the case of upstream and sidestream guarantees or securities.

In certain circumstances, a company will be able to show that a guarantee or a security is in its best corporate interest simply by looking at its own situation on an isolated level. This is typi-

cally the case where a guarantee is issued or a security granted as a downstream guarantee or security in favour of the debts of a direct or indirect subsidiary. The same is true if the company is to guarantee or secure a debt that ultimately is on-lent to it or its subsidiaries. An analysis on the precise circumstances of the case will, however, always be necessary in order to come to a definitive conclusion (particularly in view of the exact percentages held in the company in respect of which the guarantee is proposed to be given, the amount of the guarantee in comparison to the financial capacity of the company and its group, etc).

In a typical acquisition transaction with a requirement of a "full security package", most if not all group members will be asked to give guarantees and provide security for the borrowers' obligations. Guarantees and security will be downstream, upstream and cross-stream. The analysis and existence of the group will therefore be crucial to determine the corporate interest and allow the directors to go beyond the mere sphere of the entity considered on a standalone basis and consider the "common interest" of the group.

The basis of the Luxembourg analysis is a French court precedent (Cass Crim 4.02.1985, arrêt Rozenblum, Revue des Sociétés, 1985, 648–655) relating to a case where the offence of abuse of corporate assets was analysed at board level (namely where management was suspected of using assets of the company in their own personal interest "which they knew was contrary to the interest of the company"), in which the criteria for allowing a valid justification of the corporate interest for intragroup guarantees have been developed. The questions have similarly been dealt with by Belgian court precedents and authors.

In general terms, it results from precedents and doctrine to which Luxembourg courts will be likely to refer that, in the context of a group of related companies, the existence of a group interest in granting upstream or sidestream financial assistance under any form (including under the form of guarantee or security) to group companies constitutes sufficient corporate benefit to enable a company to provide such financial assistance, provided that the following conditions are met.

- The financial assistance must be given for the purpose of promoting a common economic, social and financial interest determined in accordance with policies applicable to the entire group; it is thus necessary that there is a structured group with a common aim and interest. The existence of the group is normally evidenced though the capital links. Typically in acquisition financing structures, the common financial, social or economic policy exists under normal circumstances, given that the investors that will ultimately head the group will have made a thorough analysis of the target group prior to the proposed acquisition and determined the strategy and policy for the new group, including for the reimbursement of debts and the economic and social goals for the group in the future.
- The commitment to grant the financial assistance must not be without consideration nor break up the balance between the various group companies. In other words, such commitment by a group company must not be manifestly disproportionate in view of the obligations entered into by other group companies. There is a distinction between a simple consideration and a balance between undertakings of the various entities, with both being acceptable. In other words, there is no strict requirement as to a fee or commission. It has been concluded that a justification may be found in the fact that all group companies

grant securities and guarantees for the "common good" and share the burden for other group companies. Similarly, reciprocal guarantees allowing the companies concerned to obtain financing on better terms may be justified. However, the limit of "reasonable corporate behaviour" is reached when the transaction is, for example, exclusively in the interest of the parent company.

- The financial assistance granted must not exceed the financial abilities of the committing company. In this respect, a certain practice has developed in Luxembourg and certain other jurisdictions whereby it is customary to include "guarantee limitation" language that limits the guarantee to a percentage of the net assets of the company. Although said clauses give comfort in this respect, the condition can also be met by applying a different test. Indeed, the subsidiary must not necessarily make the assumption that the parent or sister company which it guarantees will become insolvent, and must ask itself if the burden of its guarantee or its security remains in proportion to its financial capabilities. If justified by the circumstances, it may consider that the financial capacity of the group as a whole is sufficient, that the risk of default is low and that, as a consequence, the risk it is undertaking is reasonable in view of the advantages it is gaining.

It is important to carry out a case-by-case analysis, reviewing the above criteria in the given situation. A subjective fact-based judgement will need to be made by the directors (but must be objectively justifiable).

5.7 General Principles of Enforcement

Criteria for Enforcement

Enforcement triggers for guarantees or security are generally determined freely and tend to be in line with international practice regarding acquisition finance transactions. The most common enforcement triggers are therefore non-payment, commencement of insolvency proceedings and material breach of contract.

Procedures for Enforcement

Guarantees may be called generally by a simple notice to the guarantor, depending on the contractually agreed terms of the relevant agreement.

The procedures for the enforcement of security differ depending on the type of security being enforced.

Mortgages and civil and commercial pledges are most commonly enforced by a public auction sale of the secured assets. A prior summons to pay must be served on the debtor of the secured obligation before an enforcement procedure can begin (in the case of a mortgage, such summons to pay must be served by a bailiff).

For pledges on financial instruments and claims governed by the Financial Collateral Law, a number of enforcement remedies are available to the pledgee. Unless otherwise agreed between the parties, the pledgee may do the following, without the legal need of a prior notice (whereby prior notice is, however, customary – be it in the pledge agreement or in the intercreditor agreement).

- Appropriate the pledged assets or cause the appropriation of the pledged assets by a third party at a price determined prior to or after its appropriation in accordance with an agreed valuation method. The fact that the valuation methodology has to be agreed between pledgor and pledgee generally results in the relevant security document expressly providing for the appropriation option – setting out rules for the valuation for the pledged assets.
- Sell or cause the pledged collateral to be sold by private sale in a commercially reasonable

manner, by sale over a stock exchange or by public auction.
- Obtain a court order that the pledged assets are attributed to the pledgee in discharge of the secured liabilities, according to a valuation made by a court-appointed expert.
- To the extent possible, set-off the pledged assets against the secured obligations.
- If the relevant financial instruments are listed, appropriate these financial instruments at the market price, or if they are units or shares of an undertaking for collective investment that determines and publishes a net asset value on a regular basis, at the price of the latest published net asset value.
- If the pledged assets are monetary claims owed by a third party, demand payment from the third party, subject to certain conditions.

Effect of Insolvency Proceedings on Enforcement

Insolvency proceedings impose a specific order of priority for repayment and may affect the validity of certain transactions, including security arrangements or guarantees, if they were concluded during the hardening period (*période suspecte*) or up to ten days preceding the hardening period. The date on which the hardening period starts is fixed by the court, but it is a maximum of six months before the start of insolvency procedures.

However, the start of insolvency proceedings does not prevent the enforcement of security interests governed by the Financial Collateral Law, as they are not subject to the hardening period rules and remain valid and enforceable.

6. GUARANTEES

6.1 Types of Guarantees

Guarantees granted by a Luxembourg company are commonly used in the context of secured lending transactions, and are generally accompanied by a parallel debt language in order to facilitate enforcement by the security trustee.

Under Luxembourg law, there were historically two categories of guarantees, but the Luxembourg legislator has recently introduced a further alternative so there are now the following three categories.

- The first demand guarantee (*garantie à première demande*), which is "self-sufficient" because any exceptions or exemptions derived from the initial loan agreement cannot be opposed by the guarantor to the lenders. It is important for the self-sufficient character of the first demand guarantee to be clearly and unequivocally reflected in the documentation, so as to avoid any risk of requalification as a suretyship (*cautionnement*). Such risk could exist if it appears from the guarantee documentation that the guarantee is an accessory to the initial loan agreement and its related obligations. The guarantee may take the form of a letter or an agreement under private seal, and is not subject to any filing requirements.
- Suretyship (*cautionnement*), which is an accessory to a principal obligation rather than being self-sufficient. This means that the guarantor is entitled to raise all the defences that belong to the borrower under the loan agreement or that relate to the guaranteed obligations and that are inherent to the debt arising from the loan agreement, apart from the exceptions that are purely personal to the borrower. The suretyship typically takes the form of an agreement under private seal, with no further formalities. The guarantee is not subject to any filing requirements and becomes enforceable against third parties at the time of the agreement. By contrast, suretyship granted by a natural person is subject to specific formalities.

- The professional guarantee governed by the Luxembourg law of 10 July 2020 relating to professional payment guarantees (*garanties professionnelles de paiement*) (the Professional Guarantee Law), which aims to mitigate the risk of requalification of the first two categories of guarantees and in particular the risk of requalification of the first demand guarantee into suretyship, which is less favourable to the beneficiary of the guarantee. The parties to the guarantee agreement only need to make it subject to the Professional Guarantee Law to benefit from its advantages and to qualify as a professional guarantee. The agreement needs to be evidenced in writing under private seal (including in electronic form). The main feature of the professional guarantee is the flexibility and the contractual freedom given to the parties, such as the calling of the guarantee under the conditions freely determined between the parties even in the absence of a default, the exclusion of any defences related to the underlying guaranteed obligations that could be used by the debtor or the continuation of the guarantee if the guaranteed debtor is subject to insolvency proceedings or reorganisation measures.

6.2 Restrictions

The conditions that must be fulfilled by the guarantor are the same as for the pledgor (corporate power, corporate authority, corporate benefit and no financial assistance – see **5.6 Other Restrictions**).

6.3 Requirement for Guarantee Fees

While the provision of a guarantee by a Luxembourg company may generally not be without "consideration", such consideration does not necessarily have to be a fee or other monetary consideration (see **5.6 Other Restrictions**).

7. LENDER LIABILITY

7.1 Equitable Subordination Rules

Luxembourg law does not recognise the concept of "equitable subordination".

7.2 Claw-Back Risk

Claw-Back of Security in Insolvency

Insolvency proceedings may affect the validity of transactions (including guarantees and certain security arrangements) if the relevant transactions were concluded during the hardening period (*période suspecte*) or up to ten days preceding the hardening period (see **5.7 General Principles of Enforcement**). Furthermore, certain transactions may be voided even if they occur outside the hardening period, although such transactions would generally have to defraud creditors.

The following transactions are automatically void when concluded during the hardening period (or the preceding ten days, as the case may be):

- transactions transmitting property without reasonable counterpart (such as gifts, waivers) and transactions (even without transfer of property) entered into by the company for a consideration the value of which, in money or in money's worth, is significantly less than the value of the consideration provided for by the bankrupt company (ie, under-value transactions);
- payments of debts that were not yet due and payable, made by whatever means;
- payments of debts (which are due and payable) made other than in cash (or by cheque and similar payment instruments) – ie, payments in kind (*dation en paiement*), set off, sale or otherwise; and
- security granted for debts previously incurred.

It is to be noted that the Financial Collateral Law contains an important exception to the rules above.

Furthermore, under Luxembourg bankruptcy rules, legal set-off (ie, set-off between reciprocal debts that are both claimable and due for immediate payment) is still valid during the hardening period, while contractual set-off (ie, between reciprocal debts that are not claimable and/or that are not due for immediate payment) is not accepted. However, case law has decided, albeit in a restrictive way, that post-bankruptcy set-off is admissible if there is a nexus between the mutual claims to be set-off, meaning that such claims need to have a common "cause" and, therefore, be indivisible.

At any rate, the Financial Collateral Law provides that set-off between mutually owed "claims" and "financial instruments" is valid, notwithstanding the existence of any type of insolvency proceedings if it is the result of transactions that are the subject matter of bilateral or multilateral set-off arrangements or clauses. The traditional post-bankruptcy set-off prohibition may thus be neutralised to a very large extent.

The Professional Guarantee Law also specifically provides that the professional guarantee survives in the insolvency of the debtor.

Claw-back rules are also generally not an obstacle to the enforcement of valid security interests prior to the adjudication in bankruptcy if the enforcement of such security interests has been finalised before the adjudication in bankruptcy.

8. TAX ISSUES

8.1 Stamp Taxes

Unless there is a voluntary registration of the finance documents by one of the parties or a contractual obligation to do so, finance documents are, in principle, not to be registered under the laws of Luxembourg, so no stamp or registration or similar duties or taxes or charges are payable under the laws of Luxembourg. If registered, the finance documents must be registered with the Luxembourg Administration de l'Enregistrement, des Domaines et de la TVA, and a fixed or an ad valorem registration tax will be payable depending on the nature of the finance document. As an example, facility agreements or agreements including an obligation to pay, if registered, are subject to a 0.24% registration tax, whereas pledge agreements (which in practice do not include an obligation to pay but only refer to the facility agreement, which itself includes the obligation to pay) are subject to a fixed registration tax of EUR12.

It should be noted that registration taxes may also be due where the finance documents are referred to in a public deed or used before a Luxembourg official authority or any *autorité constituée*, or before a Luxembourg court, notably by being referred to in a writ, to the extent that the finance documents are subject to mandatory registration within a strict deadline (*délai de rigueur*) or in cases where the finance documents are physically attached to a public deed or any other document(s) subject to mandatory registration.

The documents subject to mandatory registration are limited in number and principally include agreements related to real estate properties located in Luxembourg (eg, a renting agreement for more than nine years) or airplanes or vessels registered under the Luxembourg flag.

8.2 Withholding Tax/Qualifying Lender Concepts

In principle, interest payments are not subject to withholding tax in Luxembourg, except in certain specific circumstances (eg, certain profit partici-

pating securities) or where the interest is paid to Luxembourg resident individuals (in which case the withholding tax is the final tax).

In such circumstances, the finance documents generally provide that the Luxembourg borrower or guarantor does not have to gross-up the amount to be paid to such a lender.

The concept of a "qualifying lender" under the finance documents covers mainly a lender benefiting from the withholding tax exemption or a treaty lender benefiting from the withholding tax exemption provided for under a relevant double tax treaty concluded by Luxembourg, or from a withholding tax at a reduced rate.

8.3 Thin-Capitalisation Rules

There are currently no thin-capitalisation rules in Luxembourg tax laws. However, with respect to the financing of participations, the tax administration generally requires an 85:15 debt-to-equity ratio for related party financing or for third party financing guaranteed by a related party. If a Luxembourg company is deemed to be over-indebted, excessive interest will not be tax-deductible and may be subject to a 15% dividend withholding tax.

In view of the new 2020 OECD guidelines on financial transactions and the Luxembourg applicable transfer pricing rules, the Luxembourg tax authorities may in the future take a different approach and require companies to determine their debt-to-equity ratio based on a transfer pricing study.

In addition, Luxembourg companies have been subject to an interest deduction limitation rule since 1 January 2019, which was introduced under the laws of Luxembourg because of the implementation of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (the ATAD I Law). Under that rule, borrowing costs exceeding the borrowing income of a Luxembourg company will be deductible in a given tax year only up to the higher of (i) 30% of the company's net revenues before interest, taxes, depreciation and amortisation (EBITDA) or (ii) EUR3 million.

The rule has no tax impact if the Luxembourg company uses the amount received under the facility agreement to finance other group companies itself, as the borrowing costs of the Luxembourg company should not exceed its borrowing income (ie, the Luxembourg company is, in any case, obliged to realise a taxable margin on its financing activities).

Similarly, where the amount received under the facility agreement is used by the Luxembourg company to acquire a participation in another company qualifying for the Luxembourg participation exemption regime, the new interest limitation rules should lead to the same result as the existing Luxembourg "recapture" rules as regards the non-deductibility of interest expenses connected to tax-exempt income. The recapture rules merely allow the deductibility of interest expenses above the tax-exempt dividend it receives. However, where the Luxembourg company realises capital gains that are exempt under the Luxembourg participation exemption rule, such capital gains remain taxable up to the amount of the interest that has been deducted over past years.

9. TAKEOVER FINANCE

9.1 Regulated Targets

The main regulated industries in Luxembourg that relate specifically to acquisition finance are credit institutions, "professionals of the financial sector" (such as investment companies, admin-

istration or transfer agents), investment funds and insurance companies. The competent regulators are generally the following:

- Commission de Surveillance de Secteur Financier (CSSF) (the regulator for the financial sector); and
- Commissariat aux assurances (CAA) (the regulator for the insurance sector).

Generally, any change of ownership of a credit institution or other "professionals of the financial sector" must be disclosed to the CSSF and, depending on the percentage of shares being acquired in the target, prior approval must be obtained. The new shareholder (with a qualifying holding) and the management must produce evidence of their professional standing (assessed on the basis of police records and any evidence that shows their good reputation and irreproachable conduct) and financial robustness.

Over the last few years, various private equity houses have acquired administration agents and other "professionals of the financial sector", and these acquisitions are subject to CSSF prior approval. In these circumstances, the timetable must obviously take into account the need for regulatory approval. In addition, the financing of the transaction must be adapted, given that the regulated business entities may be restricted in providing general guarantees or security. The structuring of the transaction to provide an adequate yet acceptable security package, from a regulatory perspective, is likely to be more time-consuming than for the acquisition of an unregulated business.

9.2 Listed Targets

When considering the financing of the acquisition of a listed company, while the target may in such instance be a Luxembourg company, it is fairly rare for the shares of such company to be listed solely on the Luxembourg stock exchange – they are more likely to be listed on a foreign exchange, so the rules of such jurisdiction would to a large extent apply.

The situation where the target company would be a Luxembourg company listed on the Luxembourg stock exchange where Luxembourg takeover rules would apply is fairly exceptional, but there have been some cases, such as the takeover of Arcelor by Mittal. In such cases, the rules of the Luxembourg law dated 19 May 2006 on public takeovers (the Public Takeover Law) implementing EC Directive 2004/25 apply.

According to Article 3(e) of the Public Takeover 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." Article 6(3) l) of the Public Takeover Law further provides that the offer document – which the offeror is obliged to prepare and make available to the public – must contain, inter alia, information concerning the financing of the bid.

While the legal provisions do not contain a "certain funds requirement", the offeror may be well advised to obtain firm commitments as to the financing of the offer, even though this is not specifically requested under the Public Takeover Law. The regulator may also enquire about the certainty of the offer financing.

Following market practice in other EU countries, offer documents governed by Luxembourg law and approved by the Luxembourg regulator generally contain provisions confirming that firm commitments have been given to finance the offer and thus guarantee the completion thereof.

It is common in Luxembourg for the rules of more than one jurisdiction to have to be complied with, and market practice will align to what

is customary in London, Paris or Frankfurt, as the case may be.

10. JURISDICTION-SPECIFIC FEATURES

10.1 Other Acquisition Finance Issues

There are no further major considerations that are important to acquisition finance practice in Luxembourg.

Elvinger Hoss Prussen is independent in structure and spirit, and guides clients on their most critical Luxembourg legal matters. The firm was founded in 1964 by lawyers committed to excellence and creativity in legal practice. The team is composed of 44 partners, 13 counsel, 170 lawyers and 150 staff employees. Clients include large corporations, multinational groups, banks and financial sector professionals (including fund managers and distributors), as well as private equity houses and some family businesses. The firm works on many different types of national and cross-border transactions, such as acquisitions, joint ventures, mergers, demergers and restructurings, and friendly and unfriendly takeovers, and covers all type of legal matters, including tax.

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