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Banking & Finance

Luxembourg: Law & Practice

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chambers.com

2020

LUXEMBOURG

Law and Practice

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1.1 Impact of Regulatory Environment and Economic Cycles

In the last few years, the economy of the Grand Duchy of Luxembourg (Luxembourg) has remained strong and the duchy has maintained its reputation as a leading international financial business centre. Indeed, it is because of its favourable business environment that, more than ten years after the beginning of the financial crisis, Luxembourg continues to attract major multinational groups and financial institutions (including, most recently, the seven largest Chinese banks), which choose to set up their EU hubs in Luxembourg and to accede to the EU Single Market. Currently, uncertainties around the pending implementation of Brexit and the COVID-19 outbreak have had only limited practical impacts on the Luxembourg loan market and an important number of financial institutions have already selected Luxembourg for their Brexit-related relocations.

The loan market, whether in the financial or the investment funds sectors, has always played a major role in the Luxembourg economy in general and in the considerable volume of debt financing structured particularly through Luxembourg. Since 2007, and despite the crisis, loans have continued to grow. In 2018 alone, they increased by 6.7% year-on-year.

Alongside traditional bank loans, the Luxembourg loan market has seen an increase in microfinance investment vehicles domiciled there. Luxembourg is also a major player in sustainable finance, with the Luxembourg Stock Exchange (the LuxSE) being the first stock exchange to introduce a dedicated platform for green, social and sustainable securities, known as the Luxembourg Green Exchange. In 2019, a third of all green bond listings worldwide were on the Luxembourg Green Exchange.

Following the footsteps of Amazon, PayPal and, more recently, Rakuten, more and more fintech companies are also choosing Luxembourg as their European base. AirBnB obtained its licence in 2019.

Given the prominent role of Luxembourg in the investment fund industry, funds-financing transactions are increasingly used by Luxembourg-regulated and alternative investment funds.

1.2 Impact of the COVID-19 Pandemic

Although we are still in the midst of the COVID-19 crisis, and it is therefore difficult to make precise assessments on its impact on the loan market in Luxembourg, the entire world economy has been hit by the crisis and the same is true for the Luxembourg economy. However, the Luxembourg authorities reacted quickly by launching a massive economic stabilisation programme very early, focused on helping companies maintain employment and cash flow and facilitate bank loans, which appears to have limited the impact of the COVID-19 crisis on the economy compared to other EU countries. The OECD and the national statistics institute (STATEC) expect Luxembourg's GDP to only decline by approximately 6% in 2020 (which is far lower than the predictions for most EU countries), and STATEC predicts that the economy will catch up with growth of around 7% next year, provided the situation returns to normal and activity gradually resumes. Although the seriousness of the situation cannot be denied, there are reasons for optimism for the Luxembourg economy and loan market.

1.3 The High-Yield Market

Luxembourg debt funds have long-standing experience in investing in secondary market trading of high-yield instruments. Luxembourg debt funds can be structured as regulated or unregulated funds and under different forms (eg, undertakings for collective investment in transferable securities (UCITS), specialised investment funds (SIFs), *sociétés d'investissement en capital à risque* (SICARs) and reserved alternative investment funds (RAIFs)).

The high-yield market has also been part of the Luxembourg landscape for a long time through the issuance of bonds on the LuxSE, which admits to trading more than 50% of the listed high-yield bond market and has continued to be very active since 2018. Most high-yield bonds are admitted on the multilateral trading facility of the LuxSE (the Euro MTF), benefiting from a flexible listing process, with reduced listing costs and a lighter disclosure framework.

1.4 Alternative Credit Providers

The Luxembourg loan market has not seen significant growth in alternative credit providers in the last few years. Granting loans to the public (and on a professional basis) is a regulated activity in Luxembourg. As a consequence, alternative credit providers in Luxembourg are limited to specific entities that operate under the supervision of the *Commission de Surveillance du Secteur Financier* (CSSF). These include debt funds and professionals engaged in the business of granting, in their own names, loans to the public. With respect to credit activities that are developing outside traditional banking circuits (ie, "shadow banking") and that consist of acquiring drawn or undrawn credit lines and transfers of loans contracted simultaneously with or immediately after those loans were granted, these are usually considered by the CSSF to be regulated credit activities.

1.5 Banking and Finance Techniques

No particular banking and finance techniques have been implemented in the Luxembourg market recently to reflect the needs of borrowers and investors. In 2016, Luxembourg adopted a new

law (the New Company Act) that, among other things, amends the Act of 10 August 1915 concerning commercial companies. This New Company Act introduced several changes, including the possibility for any type of company to issue bonds, which has resulted in additional instruments being provided to borrowers and investors.

1.6 Legal, Tax, Regulatory or Other Developments

Apart from the (temporary) measures adopted in the context of the COVID-19 pandemic, other developments include the adoption of the law of 10 July 2020 on professional payment guarantees (the PPG Act) and the fact that the Luxembourg laws of 8 April 2019 relating to the possibility of a "hard Brexit" (the Brexit Act) no longer apply.

Professional Payment Guarantee

The two traditional Luxembourg instruments within the area of the personal guarantees are the suretyship (governed by the Luxembourg Civil Code) and the autonomous guarantee (established by practice and recognised by the courts of Luxembourg). Their most important difference lies in the fact that an autonomous guarantee is independent from the underlying guaranteed obligation, whereas the suretyship is characterised by its accessory nature.

The PPG Act (which came into force on 17 July 2020) now offers the possibility – within a professional context – to make use of a new type of guarantee, referred to as the "professional payment guarantee" (PPG). The main objective of the PPG Act is to leave considerable room for the contractual freedom of the parties to accommodate their guarantee agreement according to their needs, while at the same time preserving legal certainty. The PPG Act is destined to become what the Luxembourg law of 5 August 2005 on financial collateral arrangements (the Collateral Act) achieved in the area of in rem security interests (see **5.1 Assets and Forms of Security**). It is also intended to overcome the shortcomings of the existing instruments and to allow parties to combine elements of both instruments in their PPG, without incurring the risk of requalification of an autonomous guarantee into a suretyship.

A PPG consists in a commitment by which a guarantor undertakes to pay a beneficiary, at the request of that beneficiary or an agreed third party, an amount determined according to the agreed terms in relation to one or more claims, or the risks associated with such claim(s).

Although aimed at professional users, the PPG Act does not impose any constraints as to the persons eligible to grant one, which therefore include any type of company (with or without legal personality), natural persons, mutual funds and national or international institutions. According to the *travaux parlementaires* (parliamentary discussion around its implementation), a PPG can guarantee a wide range of claims and associated risks. These may consist in obligations to pay or to deliver financial instruments or other assets, claims (present, future, contingent or hypothetical) as well as any risks associated with any such claims, whether taken individually or by reference to a portfolio.

The parties must agree to expressly submit their PPG to the PPG Act and the PPG must be evidenced in writing (in electronic form or by any other durable medium). The parties can contractually agree the object and terms of the PPG. In doing so, they may refer to the guaranteed claims for the determination of the amount, the terms and duration of the PPG, without incurring the risk of requalification into a suretyship (contrary to the autonomous guarantee).

The PGG Law further offers the possibility to use certain features already provided for under the Collateral Law and also contains a list of specific rules that will apply unless otherwise agreed, namely:

- the parties can contractually determine the events upon which the PPG can be called without necessarily the need for a default in relation to the guaranteed claims;
- the PPG can be granted in favour of a person acting on behalf of the beneficiaries of the PPG, a fiduciary or a trustee;
- the guarantor may not raise any exception arising from the guaranteed claims or risks;
- after payment, the guarantor shall have a personal right of recourse against the person having requested the issuance of the PPG and shall be subrogated in the rights of the beneficiary; and
- the guarantor will continue to remain liable to the beneficiary even if the debtor of the guaranteed claims is subject to reorganisation measures, liquidation procedures, any national or foreign insolvency proceedings or any other measure affecting the rights of creditors generally, again unless otherwise agreed.

The PPG Act has the potential to further strengthen the attractiveness of Luxembourg in domestic and international financial transactions. These may include (synthetic) securitisations or the granting of a PPG as part of a traditional financing or within the context of financing initiatives at national, European and international level (eg, helping to tackle the COVID-19 pandemic) or more generally as a valuable tool for the transfer of risk.

Brexit

In preparation of a potential "hard Brexit" the Luxembourg legislature adopted, in April 2019, the Brexit Act, according to

which UK banks had until 15 September 2019 to notify the CSSF in order to continue their existing banking activities in Luxembourg for a 12-month transitional period following the date of a hard Brexit.

However, this national transition mechanism was not applied as a withdrawal agreement of the UK from the EU was finally adopted on 30 January 2020 (the Withdrawal Agreement). According to the terms of the Withdrawal Agreement, a time-limited transition period at the EU level will last until 31 December 2020 (the Transition Period). During the Transition Period, EU laws and regulations continue to apply in the UK and UK entities can continue to work in Luxembourg on the basis of their passporting rights. As the scenario of a hard Brexit was no longer relevant, the individual decisions of the CSSF granting a 12-month transitional regime to UK entities under the Brexit Act and all related notifications lapsed.

Nevertheless, given the difficulty of reaching an agreement for a future partnership between the EU and the UK by the end of the Transition Period, impacted entities are encouraged to take all necessary steps to prepare and anticipate for the end of the Transition Period. Continued progress should also be made on contingency planning, notably to ensure that customers and investors are adequately informed of any steps taken in order to mitigate potential "cliff-edge" issues after the end of the Transition Period.

Indeed, unless an exception to the obligation to hold a licence in Luxembourg applies (see **3.1 Restrictions on Foreign Lenders Granting Loans**), UK financial institutions shall need to apply for a new licence in order to continue their activities in Luxembourg, just like any other third-country financial institutions.

2. Authorisation

2.1 Authorisation to Provide Financing to a Company

In accordance with the Luxembourg Act of 5 April 1993 on the financial sector (the Financial Sector Act), natural and legal persons that are established in Luxembourg and that grant loans to the public must be either a credit institution or a professional from the financial sector who performs lending operations.

Subject to the rules of the Financial Sector Act, lenders from other EU member states may also conduct their banking activities in Luxembourg either under their home-country licence (by setting up a branch) or under the freedom to provide services in the EU.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Lenders from third countries that conduct lending activities, or grant security or guarantees, but that are not established in Luxembourg, yet come occasionally and temporarily to Luxembourg to carry out banking activities, must be authorised by the competent authorities in Luxembourg.

However, according to the CSSF Circular 11/515, non-EU credit institutions with Luxembourg-domiciled clients do not fall within the scope of the Financial Sector Act if they pursue banking activities on a strictly cross-border basis with Luxembourg clients (eg, by email or telephone only). Therefore, these credit institutions, in theory, do not need an authorisation as required by the Financial Sector Act unless the third-country firm is considered to be providing its services in the territory of Luxembourg (notably by sending its agents to Luxembourg to provide regulated services). The latter type of situation requires a case-by-case analysis.

3.2 Restrictions on Foreign Lenders Granting Security

See **3.1 Restrictions on Foreign Lenders Granting Loans**.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no foreign currency exchange restrictions, controls or other concerns in Luxembourg.

3.4 Restrictions on the Borrower's Use of Proceeds

Aside from any contractual restrictions, borrowers are required to use the proceeds from loans or debt securities in accordance with Luxembourg law. This includes rules against corruption, money laundering and the financing of terrorism, as well as rules preventing any breach of country-specific sanctions.

3.5 Agent and Trust Concepts

The Luxembourg Civil Code recognises the concept of an agent (*mandat*). Under a mandate contract, the principal (*mandant*) grants to an agent (*mandataire*) the power to act in its name and on its behalf. Pursuant to the Collateral Act, financial collateral may be held by a security agent acting for the lender(s).

The concept of trust is also accepted in Luxembourg. Luxembourg courts recognise trusts in accordance with the principles of the Hague Convention on the Law Applicable to Trusts and on their Recognition, which was ratified by a Luxembourg Law of 27 July 2003 on trusts and fiduciary contracts.

3.6 Loan Transfer Mechanisms

Under Luxembourg law, the usual way to transfer a loan is to assign the receivables in accordance with Articles 1689 et seq of the Luxembourg Civil Code. The assignment becomes valid between assignor and assignee by the mere conclusion of an agreement between them. There is, therefore, no need to obtain the debtor's consent to the assignment. For it to bind the debtor and other third parties, the debtor will need to be notified of the assignment or it will have to accept it.

Pursuant to Article 1692 of the Luxembourg Civil Code, the assignee acquires all rights and privileges, together with the debt, that are accessory to the debt. These include (but are not limited to) the amounts owed as principal and interest of any type and nature, the security interests, the personal guarantees and any other accessory right of the loan.

Other methods of transfer are novation of receivables and contractual subrogation.

In a novation an existing creditor is replaced by a new one, resulting in the extinction of all obligations that the debtor had against the replaced creditor, including all of the associated security package.

Under a contractual subrogation, the transferee discharges the debtor from its payment obligations towards the transferor so that the debtor is subrogated in the rights of the transferor. This discharge must be expressly made by the transferee at the time of payment. All accessory rights, such as security interests, are included in the transfer.

3.7 Debt Buy-Back

Debt buy-back by borrower or sponsor is generally permitted under Luxembourg law.

3.8 Public Acquisition Finance

Under the Luxembourg Act of 19 May 2006 on takeover bids, if it concerns a bid that falls under the scope of the CSSF's supervision, the bidder must provide information on the financing for a takeover bid and specify how the consideration is to be paid. The offeror must publicly announce its decision to bid, once it has made its decision to do so, and it will have to inform the CSSF in advance.

The offeror will prepare an offer document containing the information necessary to enable the holders of the offeree company's securities to reach a properly informed decision on the bid (including any information on the bid's financing). Before this document is publicly disclosed, the bidder must submit it to the CSSF for approval.

The offer document must be prepared in a language that is accepted by the CSSF (ie, Luxembourgish, French, German, or English).

4. Tax

4.1 Withholding Tax

Repayments of principal and payment of arm's-length interest made to lenders should not be subject to withholding tax in Luxembourg. However, as an exception, the Luxembourg Act of 23 December 2005 (Relibi Act) levies a 20% final withholding tax on interest or other similar payments made by Luxembourg-resident agents or non-Luxembourg-resident agents that are established in an EU member state or an EEA member state (upon election) to Luxembourg-resident individual lenders (or assimilated). In addition, profit-sharing interest paid on certain debt instruments can be subject to a 15% Luxembourg withholding tax under certain conditions.

4.2 Other Taxes, Duties, Charges or Tax Considerations

In principle, loan agreements made under private seal should be exempt from registration formalities and should not be subject to stamp duties in Luxembourg. However, the registration of such documents might be required if they are annexed to an instrument that is subject to mandatory registration or deposited with the notary and recorded in the notarial minutes. If these cases, or in the event of voluntary registration, registration duties, which can be at a fixed rate or an ad valorem rate depending on the nature of the document, could be levied. In addition, the transfer of certain rights on lands or buildings located in Luxembourg, or rights over planes or boats registered in Luxembourg, should be subject to an ad valorem duty.

4.3 Usury Laws

Usury rules can be found in Article 1907(1) of the Luxembourg Civil Code. Interest charged on a loan can be usurious if it is clearly disproportionate to the market interest rate, and the weakness, predicament or inexperience of a borrower is exploited.

The Luxembourg Civil Code authorises a Luxembourg court (if it has jurisdiction) to reduce the rate of interest to the level of statutory interest, if it concludes that the original rate was manifestly excessive.

5. Guarantees and Security

5.1 Assets and Forms of Security

The typical security package available to secured lenders in an international financing transaction involving Luxembourg companies comprises financial instruments in the broadest sense (including shares and other equity and debt instruments, including those in book-entry form), receivables and cash deposited into bank accounts. The security created over such assets usually takes the form of a pledge (gage) or, to a lesser extent in practice, a transfer of title by way of security (*transfert de propriété à titre de garantie*), which is governed by the Collateral Act.

Perceived as lender-friendly, the legal framework under the Collateral Act, which also governs repurchase agreements (*mise en pension*) and netting arrangements (*compensation*), indeed allows creditors to create and enforce security in a cost-effective, timely and flexible manner. Moreover, they find themselves protected against insolvency proceedings and similar proceedings affecting the rights of creditors generally (see **7.2 Impact of Insolvency Processes**).

Pledges governed by the Collateral Act need to be evidenced in writing, but there is no involvement of a notary and, in principle, no stamp or registration duties are payable in connection with their creation and enforcement.

The (deemed) transfer of possession of the pledged assets, which is required for both the valid creation and the enforceability towards third parties of the pledge, depends on the type of collateral encumbered.

Financial Instruments

A pledge over shares (and other financial instruments) in registered form (which is the common form of shares issued by a Luxembourg company) is created and perfected through the recording of the pledge in said register. Disposition of financial instruments in bearer form requires physical delivery to the security taker (or an agreed-upon third party) or, in the unusual case of immobilised bearer shares of a *société anonyme*, its entry in the depositary's register. A specific set of rules governs the creation and perfection of a pledge over financial instruments in book-entry form, including:

- arrangements whereby the financial instruments are recorded in an account of the security taker;
- a tri-partite agreement between custodian, collateral provider, and collateral taker; or
- the financial instruments being designated as pledged in the books of the custodian by reference to the account on which they have been recorded.

For any other type of financial instruments, the pledge will be created and perfected through the notification of, or acceptance by, the issuer of the relevant financial instrument.

Claims

A pledge over claims (*créances*), typically receivables arising from intra-group loans but also investors' commitments in fund financing, are, from a Luxembourg law perspective, validly created and enforceable against third parties, including the debtors, by the mere conclusion of the agreement that constituted the pledge. However, the debtor, who is usually a party to the pledge agreement for that reason or is notified of the pledge, can still validly discharge its obligations towards the security provider, as long as it has no knowledge of the creation of the pledge. In cross-border financings, particular attention should be paid (due to the variety of applicable conflict of law rules) to the deemed location of the claims. Luxembourg traditionally applies, as far as the enforceability of a pledge over claims towards third parties is concerned, the law of the debtor's domicile.

Bank Accounts

Security over bank accounts located in Luxembourg (cash and/or book entry securities) is created by way of a pledge. Although it is occasionally a party to the pledge agreement, the pledge is typically notified to, and acknowledged by, the account bank/custodian based on a pre-agreed form (to the extent feasible). The acknowledgement and notices under the account pledge agreement will provide for, among other things, the acceptance by the account bank of the pledge and a waiver of its first-ranking pledge and similar (set-off) rights (from which it benefits according to its general terms and conditions) and set out the operation of accounts and the procedure that should be followed in order to block the account in case of enforcement.

Other tangibles and intangibles – such as real estate, machinery and equipment, intellectual property and a going-concern business of a company – are also available as collateral to lenders, but they imply specific types of security.

Real Property

Real property is secured by way of a mortgage (*hypothèque*) drawn up in a notarial deed that must specifically identify the said property and the obligations secured thereby. The mortgage deed needs to be registered with the tax administration registry and, for it to be valid and enforceable towards third parties, it must also be registered in the mortgage registry. The registration remains valid for a period of ten years (renewable), in the absence of which the mortgagee will lose its preferential rank.

Going-Concern Business Pledge

A pledge over a going-concern business (*gage de fonds de commerce*) covers tangibles and intangibles that form together the general business of a company, including, without limitation, its clientele, goodwill, any trademarks and patents, equipment, materials, and 50% of the stock. The creation and perfection entails substantial costs and is time-consuming. It must be entered into by written agreement and will only be enforceable against creditors after it is registered with the mortgage registry (again valid for a period of ten years but renewable). Moreover, this type of security can only be granted in favour of credit institutions (and breweries) that are specifically authorised by the government for such purposes.

5.2 Floating Charges or Other Universal or Similar Security Interests

A universal security interest over all present and future assets of a company, or floating charge, is not available under Luxembourg law to collateral holders. The type of conventional security interest under Luxembourg law that is the closest to an all-asset security is the pledge on a going-concern business.

The Collateral Act provides that the collateral giver can grant a pledge over all financial instruments and claims that it holds now or in the future without the need to specifically designate them. In practice, these pledges are created under separate agreements according to each type of asset based on their specificities in terms of creation and perfection.

5.3 Downstream, Upstream and Cross-Stream Guarantees

A Luxembourg company must grant a guarantee if it is in the corporate interest (*intérêt social*), and if it falls within its corporate purpose (*object social*). Whereas the latter can be verified through reviewing the company's corporate purpose clause, which is set out in its articles of association, the corporate interest test requires the competent body of the company (typically its board of directors or managers) to conduct a factual assessment. There is no statutory definition of corporate interest, however.

Although the above considerations apply, the general view among Luxembourg lawyers is that downstream guarantees are less likely to raise issues. Providing a cross-stream or upstream guarantee, on the other hand, should be subject to greater scrutiny.

Indeed, Luxembourg law does not expressly recognise the concept of group interest as opposed to the interest of an individual corporate entity. For a company to be able to derive sufficient corporate interest from providing a guarantee to support a parent or sister company and any further affiliates, it should be part of an integrated group with a common policy on the subject matter. Moreover, the guarantor should gain some benefit from granting the guarantee (for example, if more advantageous credit terms can be obtained at both group level and company level). Also, the financial risk that the guarantor would be exposed to under the guarantee should not be disproportionate to the company's financial means and/or the benefits derived from granting such a guarantee.

There is an established practice to limit the maximum financial risk exposure of a Luxembourg company if it grants upstream and cross-stream guarantees through adding certain "guarantee limitation" wording in the loan documents. Market practice indicates a figure of 85–99% of the guarantor's own funds increased by its intragroup liabilities. Both are determined based on its financial statements and taking into account the higher of the amounts on the date of the grant and the day when the guarantee is called.

Alternatively, the company can also derive a direct commercial benefit from providing the guarantee if it receives arm's-length remuneration.

The directors can incur civil liability, and, in more extreme circumstances, they could even face criminal penalties if a court finds that providing the guarantee is contrary to the company's corporate interest or constitutes a misappropriation of corporate assets, respectively. Moreover, one cannot rule out, if it is proven that the beneficiary of the guarantee was aware that providing the guarantee was not in the company's corporate interest, the guarantee being declared null on grounds of illegal cause.

5.4 Restrictions on Target

A Luxembourg target, most notably those in the form of a *société anonyme* or *société en commandite par actions*, is not allowed to, directly or indirectly, advance funds, make loans or grant security for the purpose of a third-party acquisition of its shares, unless the transaction falls within the ambit of the limited exemptions under the Company Act or if the burdensome "whitewash procedure" set out in the Company Act has been complied with.

There has been some debate about the applicability of these rules to a Luxembourg *société à responsabilité limitée*, given the fact that the legal provision governing criminal sanctions relating to the breach of financial assistance rules refers to the shares of this type of company. Although no conclusive view can be inferred until the legislature clarifies this further, Luxembourg lawyers generally take the view that the financial assistance rules should not apply to this type of company.

The target's directors, who engage in unlawful financial assistance, can face civil and criminal liability. A third party with standing may also seek the nullity of acts and actions that violate these rules.

5.5 Other Restrictions

There are no material restrictions aside from those described in **5.3 Downstream, Upstream and Cross-Stream Guarantees** and **5.4 Restrictions on Target**. Mortgages and pledges over going concerns will, however, be subject to registration (and renewal) fees and taxes.

5.6 Release of Typical Forms of Security

Pledges governed by the Collateral Act will normally be released upon full discharge of the secured obligations. However, there is an established practice if confirming release of a pledge by entering into an agreement to that end. Formalities are similar to those initially required in order to perfect the security and will typically include, for registered financial instruments, the recording of the release in the relevant register and notification of the release to any debtors of pledged receivables or the bank where the pledged account is held.

5.7 Rules Governing the Priority of Competing Security Interests

The order of priority among creditors and their security interests is essentially organised by intercreditor agreements, which are usually governed by foreign law.

As mentioned in **7.3 The Order Creditors Are Paid on Insolvency**, secured creditors, and creditors benefiting from privileged rights by virtue of Luxembourg law, will take precedence over the rights of unsecured creditors. Although recognised under Luxembourg law, the validity of lower priority pledges will, in principle, be subject to the express consent of any higher priority pledgees. As far as mortgages are concerned, priority is established on a first-to-file basis (in the mortgage register).

Contractual subordination is generally accepted by Luxembourg case-law and legal doctrine. In theory, contractual subordination will survive in an insolvency situation of a Luxembourg borrower.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Enforcement of a pledge governed by the Collateral Act is generally considered lender-friendly and flexible. The parties to the pledge agreement may freely determine (typically via cross-referencing the main underlying finance document) the triggering event(s) that would entitle the collateral holder to enforce the pledge under such a pledge agreement. There is no actual need for prior acceleration of the underlying secured obligations, although practical difficulties could arise.

Once the agreed upon enforcement event takes place, the pledge may be (unless otherwise agreed), at the sole discretion of the collateral holder, enforced immediately and without prior notice in accordance with the procedure set out in the pledge agreement.

The most straightforward enforcement method under the Collateral Act is the right of the collateral holder to appropriate the pledged assets or to have the pledged assets appropriated by a third party designated by it at a price determined according to valuation principles or methods agreed upon by the parties in the pledge agreement. The valuation can be carried out either before or after the appropriation of the pledged assets. Typically, appropriation is done at the pledged assets' fair value determined by an independent auditor or an investment bank or, to a lesser extent, by the security provider itself (or any other person appointed by the latter).

If the pledged assets constitute financial instruments, these can be appropriated at market price if such instruments are listed on an official Luxembourg or foreign stock market or at the price of the latest published net asset value if they are units or shares of an undertaking for collective investment.

Other options for enforcement are a private sale by the collateral holder at arm's-length conditions (conditions commerciales normales) for which no specific procedure or timeframe is provided under Luxembourg law or a public sale (organised at the discretion of the collateral holder or, as the case may be, by a stock exchange).

The collateral holder may also seek the attribution of the pledged assets in court. A court-appointed independent expert will carry out an assessment of the value that will be attributed to the pledged assets.

A collateral holder can also proceed to a set-off between the secured obligations and the pledged assets or seek direct payment if it concerns a pledged monetary claim owed by a third party.

Enforcement of a pledge over bank accounts typically takes the form of blocking of the account (to the extent that it is not yet blocked prior to an enforcement event) and the right for the collateral holder to take control of the account (including the right to demand direct payment or transfer of the amounts standing to the credit of such an account).

6.2 Foreign Law and Jurisdiction

The choice of forum and governing law of the contract will be recognised and given effect by the courts of Luxembourg. If it relates to contractual obligations, the courts will apply the provisions of Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations (Rome I Regulation) and the corresponding provisions of Luxembourg law. If it relates to non-contractual obligations falling within the scope of Regulation (EC) No 864/2007 of 11 July 2007 on the law applicable to non-contractual obligations (Rome II Regulation), it will apply the provisions of the Rome II Regulation.

Submitting a contract to the jurisdiction of the court of another EU member state or of a third country is legal, valid, binding and enforceable under Luxembourg law.

6.3 A Judgment Given by a Foreign Court

The courts of Luxembourg will recognise as valid – and will enforce – any final, conclusive and enforceable civil or commercial judgment obtained in a court of an EU member state resulting from proceedings initiated after 10 January 2015 in accordance with, and subject to, the provisions of Council Regulation (EU) No 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (the Brussels I bis Regulation).

A final, conclusive and non-appealable judgment obtained in a court of a third country will be recognised and enforced by the courts of Luxembourg in accordance with the general provisions of Luxembourg procedural law for the enforcement of foreign judgments originating from countries that are not bound by the Brussels I bis Regulation or that are not signatories to the Lugano Convention of 30 October 2007 on jurisdiction, recognition and the enforcement of judgments in civil and commercial matters or to the Hague Convention of 30 June 2005 on Choice of Court Agreements.

Pursuant to these rules, an enforceable judgment rendered by a third-country court would not directly be enforceable in Luxembourg. However, a party that obtains a judgment in a third-country court may initiate enforcement proceedings in Luxembourg (exequatur) by seeking enforcement of the third-country court judgment from the Luxembourg District Court (*Tribunal d'Arrondissement*), pursuant to the rules of the New Luxembourg Code of Civil Procedure. The District Court will authorise the enforcement in Luxembourg of the third-country court judgment, without re-examining the merits of the case if it concludes that the following conditions are met:

- the third-country court judgment contains measures of enforcement and is enforceable (*exécutoire*) in the third country concerned;
- the jurisdiction of the third-country court is found, according to Luxembourg private international law rules and to the applicable rules of the third country concerned;
- the third-country court has acted in accordance with its own procedural laws and has applied to the dispute the substantive law that would have been applied by Luxembourg courts;
- the principles of natural justice have been complied with, and the judgment was pronounced following proceedings in which the counterparty had the opportunity to appear and, if it did appear, to present its defence; and
- the third-country court judgment does not contravene Luxembourg public order and was not obtained fraudulently.

Finally, an arbitral award obtained as a result of an arbitration proceeding can be enforced in Luxembourg without having the merits of the case re-examined provided that all the requirements of the enforcement procedure set out in Articles 1250 and 1251 of the New Luxembourg Code of Civil Procedure are fulfilled. The president of the District Court may refuse such enforcement on the grounds of provisions contained in international treaties (notably pursuant to Article V of the New York Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards) and on grounds of Article 1251 of the New Luxembourg Code of Civil Procedure.

6.4 A Foreign Lender's Ability to Enforce Its Rights

No matters, other than those mentionedin **6. Enforcement**, will have the effect of affecting the ability of a foreign lender to enforce its rights, except that a Luxembourg court, or other competent authority, to which an enforcement order is presented, may require a translation of that enforcement order into French or German.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

Luxembourg law offers the following types of judicially managed company rescue or reorganisation procedures outside of insolvency:

- deferment of payment (*sursis de paiement*);
- reaching of a formal arrangement with creditors in order to avoid bankruptcy (*concordat préventif de la faillite*); and
- controlled management (*gestion contrôllée*).

Deferment of payment, and reaching a formal arrangement with creditors to avoid bankruptcy, even though these have never been formally abolished, are not often used in practice. Con-

trolled management proceedings, although occasionally applied for, are also not frequently used because they are not always successful and generally lead to bankruptcy proceedings.

Against this background, and with the aim of adjusting Luxembourg insolvency laws to today's needs, a substantial modernisation of Luxembourg insolvency law is underway in the form of the draft bill (No 6539), which was first introduced in February 2013 and, as of 2020, is still being debated in Parliament. The contemplated reform, which is inspired by Belgian law, consists of different components (ie, preventive, restorative, punitive, and social components), so that the issues of businesses in difficulty can be tackled and the opening of formal bankruptcy proceedings can be prevented.

There is an important preventive component that deals with the collection of information in order to detect, at an early stage, companies in financial distress. This is through the set-up of different indicators and the possibility for companies experiencing difficulties to apply for measures aiming at the preservation and reorganisation of their business. These measures comprise both out-of-court amicable agreements with creditors (with the possibility of having a mediator appointed) and judicial reorganisation procedures, which will replace the existing rescue proceedings.

Deferment of Payment
A commercial company can obtain a deferment of payment by court order if a majority of its unsecured creditors, representing three quarters of its outstanding unsecured liabilities, adhere to the demand for deferment. The deferment of payment is available only to a debtor that either (i) still has sufficient means or assets to repay all its creditors (in principal and interest) based on its duly verified balance sheet, and which is only temporarily unable to pay its debts as a result of extraordinary and unpredictable circumstances; or (ii) if its situation, although temporarily in deficit, plausibly indicates that the company's financial situation could improve. During the period of payment suspension, the debtor is only allowed to manage its business under the supervision of a court-appointed commissioner.

The rights of creditors are suspended during the payment deferment period. However, the suspension does not apply to tax or other government charges or certain privileged claims or debts owed to certain secured creditors (in particular mortgagees or collateral holders under the Collateral Act).

Reaching a Formal Arrangement with Creditors in Order to Avoid Bankruptcy
Reaching a formal arrangement with creditors allows a company that meets the conditions of bankruptcy, and that is unfortunate and has acted in good faith, to negotiate a settlement or a rescheduling of its debts with its creditors in order to avoid bankruptcy. All this is done under the supervision of the court and with its approval. An acceptable proposal is subject to approval by a majority of the company's creditors representing three quarters of all of the company's outstanding, unchallenged, or provisionally accepted claims. Secured creditors may only vote if they waive their rights of priority. A secured creditor who does not participate in the vote will not be bound by the formal arrangement and may continue to enforce its rights against the company.

Controlled Management
A company that has lost its creditworthiness or that has difficulties in meeting all of its payment obligations and that is a good-faith debtor can apply for the controlled-management scheme in order to have its business reorganised or have its assets sold under good sales conditions.

If the initial application is not rejected, the court will appoint an investigating judge (*juge délégué*) who will draw up a report on the financial situation of the applicant's business. At this stage, the applicant may not carry out any disposition, grant mortgages, conclude contracts, or accept any movable asset without authorisation from the investigating judge.

If the court accepts the application and orders the controlled management that is being sought, it will place the applicant's assets in the hands of the administrators, whose task is to draw up a reorganisation or liquidation plan within the deadlines set by the court. From the date of the court order, the applicant may not carry out any act (including receiving funds, lending money, granting any security, or making any payment) without the prior authorisation of the administrators. If the court decides to dismiss the application, it may open bankruptcy proceedings if the conditions for a bankruptcy order are met.

The plan must be approved by a majority of the creditors representing at least half of the applicant's liabilities (according to the value of their claims that have not been challenged by the administrators). Any creditors who abstain from voting are considered to have accepted the plan. The court retains residual discretion to reject a judicial commissioner's plan that has been approved by creditors, or to ask the administrators to propose an amended plan. The judgment approving the plan will bind the company and its creditors, joint debtors and guarantors. If the company defaults under the plan, any creditor may start court proceedings against the debtor to seek cancellation of the plan. Furthermore, if the plan is unsuccessful, the court may terminate it and declare the company bankrupt.

Throughout the entire court procedure, any subsequent enforcement proceedings or actions, even if they are brought by privi-

leged creditors (including creditors who are privileged as pledge holders or mortgagees), are stayed, save what is provided for in the Collateral Act.

7.2 Impact of Insolvency Processes

From the date of the judgment declaring a Luxembourg company bankrupt (faillite), the bankrupt company's directors are automatically and immediately divested of the administration and disposition of the assets of the company, which are entrusted to one or more court-appointed bankruptcy receivers. The bankruptcy receiver will represent the interests of both the general body of creditors and the bankrupt company and will collect and sell the debtor's assets under the supervision of a judicial commissioner, who is appointed by the court.

Enforcement actions against the bankrupt company by unsecured creditors and creditors with a general priority right (privilège général) are suspended after the bankruptcy adjudication. Secured creditors including, in particular, any lenders benefiting from a pledge governed by the Collateral Act may still enforce their rights.

Indeed, with the sole exception stipulated in the provisions of the Act of 8 December 2000 on the over-extension of debt (which is irrelevant for commercial transactions), national or foreign provisions governing reorganisation measures, winding-up proceedings or other similar proceedings and attachments do not apply to Luxembourg collateral arrangements governed by the Collateral Act and do not constitute an obstacle to the enforcement of such financial collateral arrangements and to the parties' performance of their obligations thereunder (save in the case of fraud). The financial collateral arrangements, as well as the enforcement events and the valuation and enforcement measures agreed upon by the parties, are valid and enforceable against third parties, commissioners, receivers, liquidators and other similar persons. This is so notwithstanding reorganisation measures, winding-up proceedings or any other similar national or foreign proceedings, and even if they were entered into during the pre-bankruptcy hardening period.

The Collateral Act further extends the insolvency safe harbour to financial collateral arrangements governed by laws other than Luxembourg law if the security provider is established in Luxembourg. To benefit from this additional safe harbour, the foreign-law-governed security agreements should be "similar" to Luxembourg law financial collateral arrangements and should involve financial instruments and/or claims within the meaning of the Collateral Act. Accordingly, and assuming that the foreign-law-governed security arrangement were valid, enforceable and duly created and perfected under its governing law and all other relevant laws, if a Luxembourg court were to consider such security arrangement as "similar", it would normally exclude the application of any Luxembourg insolvency and pre-insolvency rules that can be invoked before it for the purpose of challenging the foreign-law-governed security. However, in the absence of any guidance in the Collateral Act (including the legislative preparatory works) and authoritative court precedents, no definitive opinion can be expressed on the characterisation or test of what is considered to be "similar" and on the relevant conditions for determining the same.

7.3 The Order Creditors Are Paid on Insolvency

Under Luxembourg insolvency law, the fundamental principle is that all creditors of a particular class participate in the asset pool equally, in proportion to the size of their claims (the pari passu principle of distribution). Accordingly, if liabilities exceed assets (which will normally be the case), no creditor will be completely satisfied with what it will receive for its outstanding claims. However, there are various exceptions to the pari passu principle, which ensure that certain claims will be paid as priority to other claims.

First on the list of priority debt repayments are the expenses incurred for administering the bankruptcy (including the fees of the bankruptcy receiver) and the costs of contracts that were continued or entered into after the start of the bankruptcy proceedings.

Secured creditors are considered to be "outside of the bankrupt estate" (hors la masse), meaning that they are not, in principle, in competition with the other creditors of the bankrupt company as regards the distribution of the proceeds generated from the sale of their secured assets. Therefore, they generally retain their right to enforce their security.

However, certain creditors of an insolvent Luxembourg company benefit from preferences arising by the operation of law, which may supersede the rights of secured creditors. These are notably the salaried employees of an insolvent company, the Luxembourg tax authorities and the Luxembourg social security institutions. These benefit from a general privilege, which is determined by law, over movables in relation to specific claims. This general privilege ranks higher in principle than the rights of any other secured creditors other than, according to Luxembourg legal practitioners, creditors holding security under the Collateral Act (although the latter does not expressly state this).

Any proceeds remaining after the preferred creditors are paid will be distributed among the ordinary unsecured creditors (créanciers chirographaires), each in proportion to the size of their claims, and, in the very last instance, they will be distributed to the shareholders if there are any surplus left.

7.4 Concept of Equitable Subordination

No concept of equitable subordination exists under Luxembourg law.

7.5 Risk Areas for Lenders

Certain acts performed, transactions entered into, or payments made by a bankrupt company during the pre-bankruptcy "hardening period" (*période suspecte*), and for certain transactions during an additional period of ten days before the commencement of such period, are subject to cancellation by the court at the request of the bankruptcy receiver, and some of them must be proved to be concluded with the knowledge of the bankrupt company's cessation of payments. The hardening period is set by the Luxembourg court and dates from the day when the relevant company actually ceased its payments, but it will not precede the bankruptcy judgment by more than six months.

Regardless of the hardening period, the creditor has the right to challenge any fraudulent payments and transactions that were made prior to the bankruptcy (actio pauliana).

The above risks do not, however, apply to the financial collateral arrangements (including pledges) governed by the Collateral Act; the latter expressly recognises the validity and enforceability of such arrangements, even if they were entered into during the hardening period.

8. Project Finance

8.1 Introduction to Project Finance

Project finance is not frequently used for projects based in Luxembourg itself, but is made use of by project companies that are incorporated in Luxembourg and that borrow funds to implement projects abroad. Projects in connection with Luxembourg cover the entire scope of projects traditionally encompassed by project finance (eg, infrastructure, real estate, energy, and public-private partnerships (PPP)).

Luxembourg's legal framework for project finance is essentially the same as that which applies to other financings. In specific industry sectors the underlying project can be affected by specific regulations, such as those governing public procurement, building permits, environmental laws, or other industry-specific legislation.

8.2 Overview of Public-Private Partnership Transactions

Since the first PPP in 2009 (for the financing, construction and maintenance of a school campus), only a few PPPs have occurred in Luxembourg.

Luxembourg does not have a specific body of law governing PPPs. However, the Constitution of Luxembourg requires a specific prior act of approval for:

- any acquisition of an important real estate property by the Luxembourg state;
- any large-scale infrastructure project or a large building for the benefit of the Luxembourg state;
- any important financial commitment by the Luxembourg state (ie, a commitment of more than EUR40 million); or
- any financial commitment by the Luxembourg state for more than one fiscal year.

Moreover, pursuant to the Luxembourg Act of 13 December 1988 on municipalities, Luxembourg municipalities are only allowed to enter into an agreement with private persons if it concerns projects in the public interest of the municipality. Transactions of more than EUR100,000 will have to be approved by the Luxembourg Ministry of Home Affairs. Municipalities wishing to acquire shareholding interests in a private company must also be authorised by a Grand Ducal Regulation.

Finally, PPPs are affected by other Luxembourg laws and regulations, including public procurement rules, building permits, environmental and health laws. In addition, contributions to the project from public funds, which can take the form of government guarantees or other credit enhancements, must comply with applicable EU law rules restricting state aid.

8.3 Government Approvals, Taxes, Fees or Other Charges

Since there are no specific laws in Luxembourg governing project finance transactions other than the rules mentioned in **8.1 Introduction to Project Finance** and **8.2 Overview of Public-Private Partnership Transactions**, no tax, fee, or other charge is required in these transactions.

8.4 The Responsible Government Body

The Ministry of Energy, the Luxembourg Institute for Regulation, and the Government Commissioner for Energy are the responsible government bodies under the Luxembourg Act of 1 August 2007 on the organisation of the electricity and gas markets and the Luxembourg Act of 10 February 2015 on the organisation of the oil and petroleum market.

The Ministry of Home Affairs and the Prefects are the responsible government bodies pursuant to the Luxembourg Act of 21 April 1810 on mines, mines companies and quarries.

8.5 The Main Issues When Structuring Deals

Risks associated with a project depend on the nature of that project and the parties involved. They can involve repayment risk, operational, political, and legal risks.

These risks can be mitigated by suitable due diligence of the parties involved and the appropriate structuring of the legal framework of the project.

8.6 Typical Financing Sources and Structures for Project Financings

In Luxembourg, financing sources and structures available for project financings generally include loans from credit institutions, international development banks and financial market instruments (such as bonds and asset-backed securities).

For bank financing, the loan documentation usually consists of the loan agreement, the security documents related to the assets concerned by each project (eg, pledge agreements over the shares of the project company, receivables pledge agreements and bank account pledge agreements), and any other documents relevant to the specific project (construction agreements, supply agreements, leases, maintenance contracts, management agreements and insurance).

8.7 The Acquisition and Export of Natural Resources

Except for certain restrictions under environmental and health protection laws and applicable sanction regulations, there are no specific issues associated with the acquisition and export of natural resources in Luxembourg.

8.8 Environmental, Health and Safety Laws

The main environmental, health and safety laws in Luxembourg are now codified in the Luxembourg Environmental Code, which has been in force since August 2019. Other specific rules can also be found in a multitude of EU rules, Luxembourg laws, regulations, and technical implementing texts.

There is no single regulator for environmental, health and safety matters. Those matters are administered by the Ministry of the Environment, Climate and Sustainable Development, the Ministry of Home Affairs and the Ministry of Health.

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