LUXEMBOURG

Law and Practice

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1. Market

1.1 Debt Finance Market Performance

Located in the heart of Europe, Luxembourg remains an attractive location for international groups, investors and banks to establish their activities or investments. It remains a prime jurisdiction for debt, credit and opportunities funds and other major players in acquisition financing or development financing. Although the general context of inflation is not favourable for real estate financing, sustainable financing (and the development of the green stock exchange) is still growing.

The emergence of debt funds as an alternative to regular third party debt has kept the market busy during the last year, as have restructurings, whether by means of a consensual route or by enforcing Luxembourg security.

1.2 Market Players

Luxembourg is the second most popular financial jurisdiction for investment funds in the world, after the United States of America, and is the go-to place to establish new investment funds carrying on investments in Luxembourg and abroad. During the past two years in particular, debt funds have become an alternative to the usual European or international banks when looking for external financings.

Being an onshore, stable jurisdiction of good repute, Luxembourg is the go-to location to structure acquisitions, investment vehicles and financing in general. Luxembourg's attractiveness is further enhanced by the efficiency of the enforcement of collateral granted over Luxembourg companies.

Luxembourg is also recognised for its stock exchange, where debt securities are listed on regulated markets or the Euro MTF market, but the country is also known for its innovation as the world's first and leading platform dedicated exclusively to sustainable finance.

Based on the above, Luxembourg is able to attract major players – whether local, European or international, banks or investment funds or other lending or investment vehicles – who choose to provide their services, make investments, attract clients or list their securities.

1.3 Geopolitical Considerations

The already fragile market is suffering from the geopolitical situation and the related crisis in Europe, with inflation, increases in interest rates and concerns about asset class pricing slowing it further.

Despite this turbulence, the Luxembourg market remains stable, although the regularity of deals has been impacted. On the one side, the banking and finance industry and the cross-border market remain dynamic in terms of either pure financing or refinancing, as many credit agreements have been renegotiated to extend their term or amend the financial covenants. On the other side, a number of restructurings were implemented in 2023, either through a pure corporate or debt restructuring or by means of enforcement. These trends remain applicable for 2024, although market players predict an increase in transactions and new deals for the last quarter of the year.

2. Types of Transactions

2.1 Debt Finance Transactions

As the Grand Duchy of Luxembourg is a rather small country, few industrial players are present and real estate assets are rarely located in Lux-

embourg. Nevertheless, Luxembourg vehicles are often used to structure acquisition and related financing, irrespective of their location. Therefore, acquisition finance and debt restructurings are commonly structured via Luxembourg.

Bond issuances are more frequently used, including in the case of restructurings. Their terms and conditions are usually governed by US or English law, but Luxembourg law-governed terms and conditions are on the rise due to the appetite and flexibility of the Luxembourg markets.

In addition, Luxembourg law expressly allows the issue of bonds by a Luxembourg company under a foreign law and the possibility to disapply all provisions of the Luxembourg Law of 10 August 1915 on commercial companies, as amended, relating to bond issuances.

Finally, Luxembourg law has recently added additional flexibility by extending the possibility to issue bonds (publicly or not) to additional forms of companies.

3. Structure

3.1 Debt Finance Transaction Structure

The main financing documents, such as bank facility agreements, are based on Loan Market Association (LMA) or Loan Syndication and Trading Association (LSTA) standard loan agreements.

Structures involving Luxembourg entities may differ depending on the aim of the financing transaction and the circumstances. For example, a specific holding company may be implemented at an upper level in order to allow the roll-over of management and key persons. Another example would be if there is an issuance of notes or bonds at the acquisition company level and a senior or mezzanine loan is granted at the holding company level (in order to separate the security package).

A typical structure would be to have a top or master Luxembourg holding company receiving the funds and acting as an umbrella company and various Luxembourg or foreign law-governed subsidiaries holding the relevant “silos” structure. Another typical structure is to have a Luxembourg holding company acting as a joint venture company for investors, holding itself a Luxembourg company or a foreign subsidiary that will be the parent of the targeted company.

4. Documentation

4.1 Transaction Documentation

In almost every financing, a Luxembourg vehicle would be financed by its parent, either by means of equity (shares, premium or reserves) or by debt (loans or other debt instruments). The external debt portion can take various forms, such as senior loans, mezzanine loans, first and second lien and PIK loans or a debt securities issuance. The form used varies depending on the financing needs, the market conditions and the availability of certain sources of financing or the needs of certain lenders.

International banks usually grant the senior loans but would tend to mitigate their risk by syndicating the debt shortly after the first utilisation. Syndication occurs within six months to a year, and allows other participants such as securitisation vehicles or other debt funds to hold a portion of the debt.

With the rise in interest rates and international banks being more cautious before granting a loan, a new player has emerged: debt funds have seized the opportunity of the crisis to take a place in the debt market. Although they are more reactive and more adapted to the relevant market, their funding may be rather expensive, depending on the investors' appetite for the financing risk.

4.2 Impact of Types of Investors

The terms of a bank loan facility agreement will vary depending on whether or not the borrower/sponsor is in a strong position and the bank is keen to lend them funds. The provisions of the loan would then contain fewer representations and covenants and a less stringent loan-to-value ratio. However, change of control provisions and commitment fees would be more extended.

4.3 Jurisdiction-Specific Terms

Usually, terms related to insolvency proceedings and local reorganisation procedures are included in the cross-border documentation when such proceedings are not governed by Luxembourg law, as Luxembourg may apply different criteria.

5. Guarantees and Security

5.1 Guarantee and Security Packages

Luxembourg companies in acquisition structures are commonly holding companies, whose main assets consist of the holding of participations, intercompany receivables and assets on bank accounts.

The most common forms of security are pledges, assignments and transfers by way of guarantee (and, with respect to real estate, mortgages). Sometimes, Luxembourg companies also hold intellectual property rights and real estate.

The Law of 5 August 2005 on financial collateral agreements, as amended (the "Financial Collateral Law"), provides for a strong framework where financial collateral arrangements are largely excluded from the scope of bankruptcy. The security governed by the Financial Collateral Law benefits from appealing features, such as:

- confidentiality – agreements are concluded under private seal and are not subject to registration with public authorities nor published on a national register;
- an extended scope of application, as financial collateral is defined very broadly in the Financial Collateral Law;
- the existence of different rankings of pledges;
- the flexibility to regulate the rights of the parties during the term of the agreement (use of the rights, use of collateral assets, distributions, etc);
- straightforward and cost-efficient perfection requirements;
- no requirement for prior notice in the case of enforcement; and
- remoteness against the bankruptcy or insolvency of the pledgor.

The Financial Collateral Law provides for three types of security:

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

The latter is the most common collateral in acquisition finance and is usually materialised by:

- a pledge over the shares (or other type of equity securities) of the holding company located in Luxembourg;
- a pledge over its material accounts opened with a financial institution located in Luxembourg; and
- a pledge over the intragroup claims and over capital commitment (with respect to Luxembourg funds) owed to the Luxembourg company.

Shares
Pledges over shares (including future shares and related assets) and other equity instruments are a must. The pledge is entered into by the owner of the shares and the pledgee, who is usually the security agent acting for the various lenders. The agreement itself will reflect the commercial agreement related to the exercise of voting rights, the use of the pledged assets and distribution. The enforcement method shall also be specifically described (as required by law).

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 depending on the agreed commercial terms reflected in the pledge agreement. In order to permit a first ranking pledge, the account bank will be asked to waive its general pledge over the account (during the term of the pledge created under the specific pledge agreement) and to acknowledge the pledge.

Receivables
Intragroup receivables are usually pledged. As fund financings are used more often in Luxembourg, the scope of receivable pledges has been widened and can now include capital commitments (as those are assimilated to claims). The perfection requirements depend on the type of asset.

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 pledgor, the inscription of the pledge will need to be updated.

Shares and Other Forms of Securities (Equity or Debt)
The company whose securities are pledged should either be a party to the pledge agreement or be notified of the pledge.

For securities in registered form, perfection is made through registration in the relevant register of the relevant securities of the pledge. For securities in bearer form, perfection is made through registration in the relevant register held by the depositary agent.

Bank Accounts
In order to allow a first ranking pledge, the account bank will be requested to waive its general pledge to the pledged account(s) and to acknowledge and accept the pledge granted by the account holder to a third party.

Receivables
The debtor owing the pledge receivable to the pledgor should either be a party to the pledge agreement or be notified of the pledge.

A pledge over receivables due from third parties that is not perfected has an impact on enforceability and ranking, as the debtor is not aware of the pledge.

5.2 Key Considerations for Security and Guarantees

The Financial Collateral Law provides that financial collaterals may be held by a person designated by the beneficiaries (ie, security agents acting for the lender(s)) without owning any secured debt (so no parallel debt mechanism is needed). Security trustee arrangements are also recognised under the Financial Collateral Law.

Luxembourg law does not recognise the concept of trust per se, but foreign law trust arrangements are recognised in accordance with the Hague Convention of 1 July 1985 on the law applicable to trusts and on their recognition (Hague Trusts Convention), ratified by a Luxembourg law dated 27 July 2003 on trusts and fiduciary contracts, as amended from time to time. Luxembourg law has implemented the concept of the fiduciary (*fiducie*), which does not offer the same features as a trust.

Financial assistance is defined under Luxembourg law as advancing funds, making loans, granting security and providing guarantees by a Luxembourg company for the purpose of the acquisition of its shares by a third party. Financial assistance only applies to certain forms of companies, such as public limited liability companies (*société anonyme* and *société anonyme simplifiée*) and corporate partnerships limited by shares (*société en commandite par actions*). 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 employees of the Luxembourg 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 under the following conditions (called the whitewash procedure):

- 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;
- the 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 – this 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.

The granting of guarantees and security shall be examined at the company's level and is subject to corporate interest and power. The granting of upstream security or guarantees must therefore be expressly allowed or provided by the company's corporate object. The corporate interest analysis remains a matter of facts, which shall be assessed by the relevant management body of the Luxembourg company.

To the extent the above conditions are fulfilled, a Luxembourg company may only grant security or guarantee for its own benefit or the benefit of group companies or third parties (including upstream or cross-stream security), subject to certain conditions. The granting of security over its assets or the provision of guarantees are not considered to be in the normal course of business of companies, as they may result in the company being placed in distress in case of an enforcement. Whether such operation is allowed and benefits the company shall be assessed on a case-by-case basis. 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

There have been discussions to assess the possibility for a Luxembourg company to grant a guarantee or a security without monetary consideration. However, this situation would contradict the core aim of a commercial company, which is to make profits.

The discussions then moved from the granting of guarantee or security without consideration to the form or type of consideration that can be received by the Luxembourg company, whether such consideration can be direct or indirect and if the notion of profit can be extended to an indirect profit (or foreseeable profit).

Non-monetary consideration, indirect profit or expected future outcomes may now be considered as a cause to grant a guarantee or security. Therefore, the validity of a proposed guarantee or security for a company can be challenged in exceptional cases when the circumstances do not reasonably allow justification, even indirectly, of a potential benefit thereof or a motivated interest therefor.

Limits on corporate power imposed by the articles of incorporation

The articles of incorporation of the company set forth the corporate governance and the limits of decision making. The object clause, in turn, sets forth the limits within which the management is entitled to develop and carry out the company's activity.

Luxembourg companies that are party to an acquisition structure will have a financial participation company object – ie, an object limited to holding and managing participations in other companies in Luxembourg or abroad. The granting of security or guarantees (including cross and upstream guarantees) shall be expressly provided in the corporate object.

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, it can be considered as ultra vires. In such case, if the guarantee or security has been signed in accordance with the articles of association, the company shall be considered to be bound by the relevant transaction; however, its management may be held liable.

Corporate Authority

Decisions on the granting of guarantees or security fall within the competence (and under the responsibility) of the board of directors/managers, unless otherwise provided by the articles of association of the Luxembourg company. The members of the board shall take their decision based on all factual matters available to them,

draft documentation and usually the financial and commercial elements of the transaction. Particular attention should be paid to:

- the interest rate applicable to the guaranteed obligation;
- the interest payment date, reimbursement, termination dates and options;
- specific representations and warranties;
- negative pledges;
- covenants; and
- the effect of their decision on the financial capacity of the company.

The minutes of the meeting of the board of managers/directors shall reflect the discussion accordingly and the assertions made by the members in order to justify the corporate benefit. Usually, the transaction is approved together with all related transaction documents. A specific power of attorney is generally granted to any manager/director to finalise and execute the documentation.

Corporate Benefit

A Luxembourg company must always act in its corporate interest, which can be linked to the French concept of *intérêt social*.

The corporate interest is not defined by law as such, but has been developed by doctrine and court precedents. Different interpretations have been made, but 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 for its own benefit.

Whether an action is in the corporate interest of a company is a matter of fact rather than a legal issue. The board of managers is responsible for this determination, which is made on a case-by-case basis and in light of all prevailing circumstances. The assessment shall be made by the management body, and the members of the management board are solely responsible for this assessment at the level of the Luxembourg company.

The test for determining whether a Luxembourg company has acted in its corporate interest when entering into a transaction is first applied on a standalone basis. If a company is to receive appropriate remuneration in relation to the transaction it is entering into, it is generally considered that the transaction is in its corporate interest.

A company will usually be able to evidence its corporate interest simply by looking at its own situation on an isolated level. This is typically 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, or if returns are anticipated in the future. This can also be the case if the company is to guarantee or secure a debt that is ultimately on-lent to it or its subsidiaries.

In acquisition financing transactions, all group members will usually be asked to give guarantees and provide security to secure the borrowers' obligations. Guarantees and security may be downstream, upstream and/or cross-stream.

There is no Luxembourg legislation governing group companies that specifically regulates the establishment, organisation and liability of groups of companies, so the concept of "group interest" as opposed to the interest of the individual corporate entity is not expressly recognised. However, based on current French and Belgian case law, and provided that the corporate object allows the granting of guarantees

to group companies, a Luxembourg company is legitimately following its corporate interest if there is a group of companies (to which the company belongs), it can be evidenced that the company derives a benefit from granting such assistance (eg, if more advantageous credit terms can be obtained both at the group level and at the level of the Luxembourg company) and if the assistance is not disproportionate to the company's financial means and the benefits derived from granting such assistance in terms of the amounts involved.

Although the notion of a group interest is not recognised in Luxembourg, it can be evidenced by means of the equity participation in the various entities. The interest and benefit shall be common and is usually financial or social. It is also evidenced in the due diligence made on the targeted group or asset, and in the aim and strategy to be implemented by the newly formed group (refinancing indebtedness, integrating an international component related to the targeted clients or markets, or expansion).

The guarantee 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 inclusion of guarantee limitation language is not itself sufficient to justify the corporate benefit of the company.

The provision of a guarantee may be remunerated in order to justify the corporate interest and benefit of the company to grant such guarantee. Such remuneration can take different forms, such as a fee or other monetary consideration.

As underlined, the assessment of the corporate interest criteria shall be carried out a case-by-case basis, reviewing all the facts related to the applicable situation. Failure to have a specific corporate interest at the Luxembourg entity level can trigger the liability of the managers/directors (who have not done their assessment properly) and the potential annulment of the transaction on the grounds of illegal cause (*cause illicite*) if the Luxembourg courts consider the transaction to be a misappropriation of the corporate assets of the Luxembourg company. Anyone with a legitimate interest can bring an action before the Luxembourg courts (eg, shareholders, creditors of the shareholders and other creditors of the company).

6. Intercreditor Issues

6.1 Role of Intercreditor Arrangements

Almost all international acquisition financing transactions in Luxembourg include an intercreditor component or a subordination, regardless of their volume or the number of layers of financing involved. Intercreditor or subordination agreements are generally governed by a foreign law, but Luxembourg law is sometimes chosen.

Intercreditor arrangements related to acquisition finance structures set forth the commercially agreed respective rights of the finance parties as well as those of the intragroup lenders and shareholders, including ranking and priority. The application of payments and proceeds, the consequences of the occurrence of events of default and enforcement are included in the intercreditor arrangements, which also regularly include the appointment and terms of the security agent.

6.2 Contractual v Legal Subordination

Luxembourg law does not have specific provisions related to subordination itself beside the pari passu principle, which protects the principle of equality of creditors. The subordination principle will therefore fall under the freedom of contract provided under the Luxembourg civil code if a party agrees to contractually subordinate its claims to another party. Such subordination is usually dealt with in intercreditor agreements or subordination agreements, which are usually governed by English law or US law.

7. Enforcement

7.1 Process for Enforcement of Security

Criteria for Enforcement

Events of default or enforcement events are freely determined between the parties, and usually cover non-payment, the commencement of insolvency proceedings and material breach of contract.

The main financing agreements (such as the credit agreement) may provide that the debt shall be accelerated prior to the enforcement. This criteria should be checked on a case-by-case basis.

Procedures for Enforcement

Guarantees are usually simply enforced my means of notice. Such enforcement formalities are usually set forth in the guarantee agreement itself.

The procedures for the enforcement of security differ depending on the type of security being enforced. Mortgages and civil and commercial pledges are enforced by a public auction sale of the pledged assets. Debtors shall be notified by a bailiff before an enforcement procedure can begin.

For pledges on financial instruments governed by the Financial Collateral Law, several enforcement remedies are available. Unless otherwise agreed between the parties, no prior notification shall be given to allow the enforcement.

The pledgee may choose the manner of enforcement as set forth by the Financial Collateral Law. One or more of the following methods can be applied:

- appropriation of the pledged assets or causing 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 valuation methodology has to be agreed between pledgor and pledgee, and is usually provided in the relevant security agreement;
- selling or causing the pledged collateral to be sold by private sale in a commercially reasonable manner;
- by sale over a stock exchange or by public auction;
- obtaining 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, setting off the pledged assets against the secured obligations;
- if the relevant financial instruments are listed, appropriating 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; and

- if the pledged assets are monetary claims owed by a third party, demanding payment from the third party, subject to certain conditions.

Effect of Insolvency Proceedings on Enforcement

The occurrence of an insolvency proceeding rearranges the order of priority of creditors and payments. It can also challenge the validity of certain transactions (including payments, granting of guarantees or security, sale of assets) and agreements concluded during the hardening period (*période suspecte*) and/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 (plus ten days) before the start of insolvency proceedings.

However, securities governed by the Financial Collateral Law are excluded from the bankruptcy estate, and an enforcement may therefore take place.

7.2 Enforcement of Foreign Judgments

The procedure for enforcing judgments depends on the forum chosen by the parties in the relevant agreement and the country in which such judgment has been issued. If the chosen forum is located in an EU member state (including Denmark), a judgment rendered by such competent court will be recognised and enforced in Luxembourg subject to the provisions of Regulation (EU) 1215/2012 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters or Regulation (EC) 805/2004 creating a European Enforcement Order for uncontested claims.

If the judgment is issued by a UK court pursuant to an exclusive jurisdiction competence clause included in the relevant agreement, then a final and conclusive civil or commercial judgment rendered by such competent court will be recognised and enforced in Luxembourg in accordance with, and subject to the conditions set out in, the Hague Convention on choice of court agreements (the Hague Convention on Choice of Court Agreements), provided the recognition or enforcement of the judgment is not refused on the grounds specified therein.

If the chosen forum is located in Switzerland, Norway or Iceland, then a final and conclusive civil or commercial judgment rendered by such competent court will be recognised and enforced in Luxembourg, subject to the provisions of the Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.

Finally, if no enforcement treaty applies, a final and conclusive civil or commercial judgment obtained against a Luxembourg company in the competent courts of the relevant country would be recognised and enforced by Luxembourg courts, subject to the applicable enforcement procedure (exequatur) as set out in the relevant provisions of the New Luxembourg Civil Procedure Code and in Luxembourg case law. Pursuant to Luxembourg case law, the granting of exequatur is subject to the following requirements:

- the non-Luxembourg court order must be enforceable in the country of origin and must not contradict a court order already enforceable in Luxembourg;
- the non-Luxembourg court order must not infringe the exclusive jurisdiction of the Luxembourg courts and there must be a real link (*lien caractérisé*) between the case and the non-Luxembourg court;

- the non-Luxembourg decision must not violate the rights of defence and the right to a fair trial;
- the considerations of the non-Luxembourg court order as well as the judgment as such must not contravene Luxembourg international public policy or must not have been given in proceedings of a tax or criminal nature; and
- the non-Luxembourg court order must not have been rendered subsequent to an evasion of Luxembourg law or jurisdiction (*fraude à la loi*).

8. Lenders' Rights in Insolvency

8.1 Rescue and Reorganisation Procedures

Before the law on reorganisation procedures dated 7 August 2023 came into effect on 1 November 2023 (the Reorganisation Law), Luxembourg only provided for the following reorganisation procedures:

- the composition with creditors (*concordat préventif de la faillite*);
- the suspension of payment (*sursis de paiement*); and
- the controlled management (*gestion contrôlée*).

Those procedures were barely used and have been abrogated by the Reorganisation Law.

The Reorganisation Law aims to improve and modernise restructuring procedures and the insolvency legislation. It applies to commercial companies (S.A., S.à r.l., S.C.A. and S.C.S.), special limited partnership (S.C.Sp) and civil companies. Credit institutions, investment firms, insurance and reinsurances companies, investment funds and securitisation undertakings issuing financial instruments to the public are excluded from the scope of the Reorganisation Law.

The main objectives of the Reorganisation Law are to detect businesses in financial difficulties and to introduce out-of-court and in-court reorganisation procedures. The out-of-court procedure allows the debtor to propose a mutual agreement (*accord amiable*) on a payment plan relating to the reorganisation of all or part of its assets or activities, to at least two of its creditors. This mutual agreement shall be sanctioned by the court (*homologation*) in order to be enforceable. No publication will be made.

Alternatively, the debtor can apply for a judicial reorganisation procedure, which can be:

- a stay of payment (*sursis*) to negotiate a mutual agreement;
- a collective agreement (*accord collectif*); or
- a transfer of assets by court order (*transfert par decision de justice*).

Stay of Payment

The stay of payment aims to achieve a mutual agreement between the debtor and its creditors. The stay can be granted for a period of between four months and 12 months (if extended by the courts). Such procedure suspends all payments on debts incurred prior to the application. In addition, no enforcement of the debtor's claims may be continued or exercised on its assets, no seizure of assets may be made and no individual enforcement measure is allowed.

The debtor can also unilaterally suspend the performance of its obligations, except for agreements having successive executions and employment contracts. Finally, during the stay, the debtor may not be declared bankrupt, dissolved judicially (except as a consequence of

criminal activities or serious violations of the laws governing commercial companies) nor made subject to administrative dissolution without liquidation.

Collective Agreement or Reorganisation Plan

Similar to the stay of payment, the collective agreement or reorganisation plan involves all the creditors of the debtor, which shall be divided into two categories (ordinary and extraordinary creditors). The plan will only be approved if it is sanctioned by a favourable vote from the majority of the creditors in each category and representing at least half of the sums due in principal in that category.

Even if the creditors reject the proposed reorganisation plan, the courts can still approve it under the following conditions:

- the plan has been approved by at least one category of creditors entitled to vote;
- if the plan was approved by the ordinary creditors, it shall ensure that the extraordinary creditors are treated more favourably; and
- no category can receive more than the total amount of its claims.

If sanctioned by the court, the reorganisation plan binds all creditors (irrespective of their category). It shall be implemented within five years from the date of its approval by the court.

If the debtor is declared bankrupt during the stay, the plan shall be automatically revoked. The revocation of the plan deprives it of all effect, except for payments and transactions already implemented in accordance with the plan (including payments and disposals of assets or activities).

Transfer by Court Order

This procedure allows all or part of the assets or activities of the debtor in financial distress to be transferred by court order. It may be initiated by the debtor or directly by the public prosecutor.

If the transfer is initiated upon the request of the public prosecutor, a legal representative (*mandataire de justice*) shall be appointed by the court and shall be responsible for organising the transfer of all or part of the assets or activities to ensure the continuity of these (or part of them) and the preservation of employment by one or more third-party buyers. To that end, the court-appointed officer shall seek various offers, taking into consideration the going concern of the activities subject to the transfer.

Although certain provisions of the Reorganisation Law contain a number of ambiguities and uncertainties, the legal doctrine tend to agree that (save for very specific cases that shall be examined on a case-by-case basis) the security granted in accordance with the Financial Collateral Law remains enforceable if the Luxembourg debtor files for a reorganisation procedure. The professional payment guarantees also remains enforceable.

8.2 Main Insolvency Law Considerations

Under Article 437 of the Luxembourg Commercial Code, a commercial company is bankrupt when it has ceased its payments (*cessation des paiements*), and its credit is exhausted (loss of creditworthiness – *ébranlement du crédit*). Those two criteria shall be met on the day of the bankruptcy judgment by the relevant competent court. The non-payment of a single debt is sufficient to be considered as cessation of payment. The bankruptcy of a debtor can be requested by the directors/managers of such debtor if it has ceased its payment and has lost its creditworthi-

ness, or can occur at the request of a creditor or at the request of the public prosecutor, or by the court's own motion.

Once appointed by the court, Luxembourg bankruptcy receivers manage the bankrupt estate in the interest of the creditors as a whole and the bankrupt company, without being controlled by either. Receivers are not subject to any obligations to involve the shareholders or creditors in the liquidation process; while they have an obligation to obtain the best price or fair value for the assets sold in view of all relevant circumstances, they are not required to allow credit bidding, etc. The board of managers is divested and only the receiver is able to represent the company. Creditors shall file their respective claims with the receiver and the competent court.

The occurrence of insolvency proceedings may challenge the validity of certain transactions (including payments, the granting of guarantees or security, and the sale of assets) and agreements concluded during the hardening period (*période suspecte*) and/or up to ten days preceding the hardening period:

- specific transactions (eg, the granting of a security interest for antecedent debts; the payment of debts that have not fallen due, whether such payment is made in cash or by way of assignment, sale, set-off or by any other means; the payment of debts that have fallen due by any other means than in cash or by bill of exchange; the sale of assets without consideration or for materially inadequate consideration) are set aside or declared null and void, as the case may be;
- payments made for debts that are due as well as other transactions concluded for consideration during the hardening period are subject to cancellation by the court upon proceedings being initiated by the receiver if they were concluded by a relevant counterparty with the knowledge of the bankrupt company's cessation of payments; and
- regardless of the hardening period, Article 448 of the Luxembourg Code of Commerce and Article 1167 of the Luxembourg Civil Code (actio pauliana) give the receiver the possibility to challenge any fraudulent payments and transactions made prior to the bankruptcy, without limitation of time.

A set-off between reciprocal debts that are both claimable and due for immediate payment is still valid during the hardening period. A contractual set-off, however, is not permitted, unless there is a strong connection (common cause) between the mutual claims to be set off so that they can be considered indivisible.

As addressed above, the financial collateral arrangements governed by the Financial Collateral Law are considered as bankruptcy remote. Even if such financial collateral arrangements are contracted on the day of the court ruling establishing the bankruptcy of the debtor, they shall remain enforceable. The same protection applies to professional payment guarantees.

9. Tax & Regulatory Considerations

9.1 Tax Considerations

Stamp Duty

Registration duties are levied on certain legal deeds or acts. While the registration formality is compulsory for certain deeds or acts enumerated by the law, the registration of an act or a deed can also be made voluntarily. Registration of a document is also required if such document is attached to a deed which itself must be registered or deposited with a notary.

Depending on the act or operation, registration duties are either levied at a fixed amount (EUR12 in general or EUR75 for certain specific deeds) or at a proportionate amount (as a general rule, proportionate duties are computed based on the fair market value of the assets or rights transferred, except where law provides for a different basis). Proportionate registration duties apply to specific deeds or acts enumerated in the law. Deeds that are not subject to proportional duties are therefore subject to fixed registration duties.

Deeds that are subject to mandatory registration and that trigger proportionate registration duties are limited, and mostly concern agreements related to real estate properties located in Luxembourg (transfer of real estate, mortgages, etc. or aircrafts or vessels registered under the Luxembourg flag.

Documents evidencing a debt claim are not subject to mandatory registration under Luxembourg laws. If registered, a 0.24% proportionate registration duty is due (assessed on the amount of the claim), unless the debt instrument takes the form of a negotiable security.

Withholding Tax/Qualifying Lender Concepts

In principle, interest payments made by a Luxembourg company are not subject to withholding tax in Luxembourg, except under certain specific circumstances (eg, certain profit participating securities, equity instruments or instruments deemed to be equity and similar arrangements) or where the interest payments are made (or deemed to be made) by a paying agent established in Luxembourg to individuals resident in Luxembourg, in which case the withholding tax is a final tax (*retenue à la source libératoire* – RELIBI).

Loan documents typically provide for an obligation for a Luxembourg borrower to gross up interest payments made to a lender for any withholding tax becoming due, except for the aforementioned RELIBI. Furthermore, it is market practice that the obligation of the gross-up obligation is limited to lenders who are so-called “qualifying lenders” on the date of the loan agreement. In other words, it is standard that the withholding tax risk of a change in law is allocated to the borrower. The concept of “qualifying lender” essentially covers lenders to which payments can be made without being subject to withholding tax (or that benefit from an exemption) or lenders that are tax resident in a country with which Luxembourg has concluded a treaty providing for an exemption (or reduced rate) of withholding tax for interest.

Thin Capitalisation Rules

Luxembourg tax law does not provide for thin capitalisation rules other than the general arm’s length principle. If a Luxembourg company is considered to be excessively indebted, the interest on the exceeding portion of the debt financing would be treated as a non-tax-deductible hidden dividend and may be subject to a 15% dividend withholding tax.

Based on the arm’s length principle, the debt-to-equity ratio of a Luxembourg company has to be substantiated through a transfer pricing study. In the past, the tax authorities generally required an 85:15 debt-to-equity ratio as a matter of practice for (related-party or third-party) loans taken up by a Luxembourg company to finance shareholdings qualifying for the Luxembourg participation exemption regime. Considering the new OECD guidelines on financial transactions issued in 2020, the debt-to-equity ratio for such investments should now also be benchmarked.

Luxembourg applies earnings stripping rules in accordance with 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 (ATAD I). Subject to certain exclusions, the earnings stripping rules limit the deduction of the net amount of interest expenses and economically equivalent expenses (ie, the excess, if any, of such expenses over interest income) in a taxable year to 30% of EBITDA for tax purposes or EUR3 million, whichever is higher. The earnings stripping rules do not distinguish between third-party and related-party interest. Moreover, if the ratio of equity to assets of a taxpayer is equal to or higher than such ratio for the consolidated group to which it belongs, such taxpayer is excluded from the scope of the rules.

The rule should have no tax impact if the Luxembourg company uses the amounts borrowed under a loan agreement to grant other loans: in compliance with the arm's length principle, the Luxembourg company should derive interest income in excess of its interest expenses and thus the Luxembourg company should not have exceeding borrowing costs. Similarly, if the Luxembourg company uses the amounts borrowed under a loan agreement to acquire shares in another company qualifying for the Luxembourg participation exemption regime, the earning stripping rules should not adversely impact the Luxembourg company.

9.2 Regulatory Considerations

There are no particular regulatory considerations with respect to Luxembourg borrowers.

However, the granting of loans for one's own account to the public (without receiving deposits or other repayable funds from the public) by a company located in Luxembourg is subject to the holding of a professional of the financial sector (PSF) licence and to the prudential supervision of the Luxembourg supervision authority of the financial sector (the *Commission de Surveillance du Secteur Financier* – CSSF). Pursuant to Article 28(4) of the Law of 5 April 1993 on the financial sector, as amended from time to time, authorisation as a specialised PFS is required for professionals engaged in lending activity – ie, the extension of loans to the public on their own behalf. This activity is different from that performed by credit institutions in that it does not involve the collection of deposits or other repayable funds from the public. Such entity shall obtain its licence prior to starting its activities. This applies to the acquisition of loans as well as the origination of loans.

The reference to "the public" implies that lending activities between entities belonging to the same group are excluded. The CSSF has also indicated that the term "public" generally refers to a group of non-identifiable persons, and has stated that the grant of loans to a limited circle of previously determined persons is not deemed lending to the public and therefore does not fall within the scope of Article 28-4 of the Law of 5 April 1993 on the financial sector.

Finally, the CSSF has excluded from the scope of this provision lending activities where:

- the nominal value of the loan amounts to at least EUR3 million (or the equivalent in another currency); and
- the loan is granted exclusively to a professional, as defined in Article L. 010-1.2 of the Consumer Code – ie, any natural or legal person acting (including through another person acting in his/her/its own name or on his/her/its own behalf) for purposes relating to his/her/its trade, business, craft or profession.

10. Jurisdiction-Specific or Cross-Border Issues

10.1 Additional Issues to Highlight

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

Trends and Developments

Contributed by:
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Debt Finance in Luxembourg: an Introduction

Enforcement, debt restructuring and recovery

Enforcement

Where some may see financial distress or even bankruptcy, others may see opportunities. The international markets being rather inactive and the morose global financial situation caused by the general geopolitical circumstances may weaken certain businesses.

Such situations may attract investors who are waiting for the best moment to acquire a company, especially one in distress, in order either to acquire additional competence at a lower price, extending their original market, or simply to kill the competition (subject to clearance).

Those acquisitions can be done by means of enforcement, where such investors acquire the debt for a lower price and enforce it, usually to appropriate the underlying assets. Although this is a common trend, there has been an increase in enforcements, especially on Luxembourg share pledges granted over the shares of Luxembourg holding companies. As there is a single point of enforcement and the means of enforcement are efficient and cannot be stopped (they can only be challenged afterwards), Luxembourg remains the go-to jurisdiction.

Although some banks or noteholders may be ready to enforce, borrowers may still push for a more consensual solution, even if it comes with a high price, in order to preserve their credibility or their reputation.

Debt restructuring

As a result of the global trend of rising interest rates and inflation, borrowing costs have become a real burden on financed structures. Some borrowers, adopting a prudent approach, have reached out to their lenders to (re)negotiate the credit terms, extend the repayment deadlines or term, re-evaluate ratios and financial covenants or increase the secured liabilities in order to avoid being in default.

Anticipation is really a key word in those negotiations but providing comfort to the banks is also essential, as they are becoming a bit sensitive on money lending if the borrower is not performing.

In some cases, the Luxembourg borrower would request an additional financing but it would not come cheap and would in fact increase the indebtedness burden on such borrower, which is already in trouble. The banks are also more prudent and request additional security or a guarantee, or increase their fees in order to cover the additional risk taken.

However, those debt restructurings would avoid an even worse scenario, such as bankruptcy.

As market expectations remain cautious, albeit better than last year, (re)negotiations of credit terms, especially on the covenant side (financial or loan to value mostly), and extensions of maturity are expected throughout 2024.

The market remains prudent and awaits the decrease of interest rates and a global improvement in the general economic situation, especially in terms of geopolitical risks and tensions (particularly as the conflicts in Ukraine and the Middle East have escalated over the last couple of weeks).

Recovery – introduction of new reorganisation procedures

Before the law on reorganisation procedures dated 7 August 2023 came into effect on 1 November 2023 (the Reorganisation Law), Luxembourg only provided for the following reorganisation procedures:

- the composition with creditors (*concordat préventif de la faillite*);
- the suspension of payment (*sursis de paiement*); and
- the controlled management (*gestion contrôlée*).

Those procedures were barely used and have been abrogated by the Reorganisation Law.

The Reorganisation Law aims to improve and modernise restructuring procedures and the insolvency legislation. It applies to commercial companies (S.A., S.à r.l., S.C.A. and S.C.S.), special limited partnership (S.C.Sp) and civil companies. Credit institutions, investment firms, insurance and reinsurances companies, investment funds and securitisation undertakings issuing financial instruments to the public are excluded from the scope of the Reorganisation Law.

The main objectives of the Reorganisation Law are to detect businesses in financial difficulties and to introduce out-of-court and in-court reorganisation procedures. The intention is to give debtors a second chance and to avoid bankruptcy.

The out-of-court procedure allows the debtor to propose a mutual agreement (*accord amiable*) on a payment plan relating to the reorganisation of all or part of its assets or activities, to at least two of its creditors. This mutual agreement shall be sanctioned by the court (*homologation*) in order to be enforceable.

Alternatively, the debtor can apply for a judicial reorganisation procedure, which can be:

- a stay of payment (*sursis*) to negotiate a mutual agreement;
- a collective agreement (*accord collectif*); or
- a transfer of assets by court order (*transfert par decision de justice*).

A few debtors have already applied for these new reorganisation procedures in Luxembourg, and some have been successful. Debtors applying to obtain a stay of payment (*sursis*) are generally small and local businesses. Luxembourg courts have already ruled that the procedure of transfer of assets by court order (*transfert par decision de justice*) is not applicable for holding companies, as their main assets are participations in other companies.

To date, petitions or filings for these new reorganisation procedures are relatively rare. Whether those and, in particular, the collec-

tive agreement (*accord collectif*) will be used as restructuring tools for group companies where the top holding company is located in Luxembourg is questionable, as such procedure may incur a cram-down of the creditors who can only be divided into two classes (ordinary creditors and extraordinary creditors), and the court may impose such cram-down on all the creditors of the Luxembourg debtor. Although the intention of the legislature was to implement a restructuring toolbox to give the Luxembourg debtor a second chance, the use of such reorganisation procedure might be limited to local businesses.

From a creditor perspective, and particularly where a double Luxco structure is used to secure the financing granted to the Luxembourg entity or its subsidiary(ies), pledges and other financial collateral arrangements governed by the Luxembourg Law of 5 August 2005 on financial collateral arrangements, as amended, should remain enforceable and should maintain their bankruptcy remoteness feature. The same applies to professional payment guarantees governed by the Law of 10 July 2020. Luxembourg should therefore continue to be an attractive jurisdiction for debt and security structuring, remaining a strong lender-friendly jurisdiction.

Emergence of alternatives to traditional bank financing

Private debt equity

The Luxembourg market continues to feel the impact of the financial crisis, especially with the increase in interest rates and inflation during 2023. Compared to other jurisdictions, midsized transactions (up to EUR250 million) have been less affected by the financial crisis, while large cap transactions (over EUR250 million) drastically decreased, although the market was not totally frozen.

As traditional banks became a bit reluctant to grant or extend credits, or tightened their conditions or required additional security, borrowers sought alternative means of borrowings.

Luxembourg debt funds took this opportunity to provide direct lending to borrowers and thereby position themselves in the Luxembourg market and abroad. The observed growth in debt financing during the last two years can be attributed to various factors that have collectively contributed to the utilisation of debt financing as a means to access capital for business and economic activities. Such factorsinclude:

- overall economic growth;
- globalisation fostering business expansion;
- increased entrepreneurial activities;
- real estate development requiring substantial capital; and
- government stimulus programmes that may have encouraged borrowing for various purposes.

Depending on the risk appetite of their investors, debt funds may lend directly to a variety of borrowers, such as midmarket companies. They also offer more flexibility on the form and features of the loans granted, such as PIK, mezzanine, bullet loans, unitranche financing, etc. However, those financings usually come with other challenges, such as higher interest rates.

It is easy to see how private debt activity, including venture debt activity, is a natural extension of private equity. Whereas private equity funds in years past might have had a small amount of debt in a portfolio, some appear to be looking at becoming high-volume debt providers or managing a book of loans.

It is also worth noting that private equity firms are particularly relying on mezzanine debt as an asset class. For example, in August 2023, BlackRock Inc. (a renowned provider of investment management services based in the United States) completed the acquisition of Kreos Capital Group, a leading growth and venture debt financing solution provider headquartered in the UK. The specific financial terms of the acquisition were not publicly disclosed, but this strategic move by BlackRock is aimed at fortifying its global presence and capabilities as a prominent credit asset manager. Through this acquisition, BlackRock endeavours to expand its offerings, providing clients with a wider range of private market debt options and diversified investment solutions.

However, lending to the public (without collecting funds from the public) is a regulated activity supervised by the Luxembourg financial supervision authority (*Commission de Surveillance du Secteur Financier* – CSSF). Professionals performing lending operations engage in the business of granting loans to the public for their own account. There is an assumption that the activity is the main activity carried out by the company, and that it is performed repetitively.

There are a couple of exemptions, such as granting loans to one or several companies belonging to the same group (to which the entity concerned belongs) or lending to a targeted identifiable person (limited circle exemption). There is also a professional exemption, which excludes loans with a nominal value of at least EUR3 million and loans granted exclusively to a professional, as defined in Article L. 010-1.2 of the Consumer Code – ie, any natural or legal person acting (including through another person acting in his/her/its own name or on his/her/its own behalf) for purposes relating to his/her/its trade, business, craft or profession.

In addition, some professionals are specifically excluded from the scope of this legislation, including UCIs, SIFs, pension funds, SICARs and other persons carrying out an activity the taking up and pursuit of which are governed by special legislation in Luxembourg.

In almost all cases, private debt funds would not fall within the scope of the professional as understood in financial sector law or would fall under an exemption accepted by the CSSF.

Capital markets

In addition to direct lending provided by private debt funds, borrowers have also turned to the issuance of debt securities to raise (additional) funds.

Luxembourg is recognised for its stock exchange, where debt securities are listed on regulated markets or the Euro MTF market, but the country is also known for its innovation as the world's first and leading platform dedicated exclusively to sustainable finance. Indeed, it gives issuers and investors an opportunity to shape the future of finance, especially with the pressure applied globally to comply with ESG criteria. In 2022, the Luxembourg stock exchange admitted the first security tokens on its Securities Official Lists.

Although the terms and conditions are usually governed by US or English law, Luxembourg law-governed terms and conditions are on the rise due to their flexibility. Luxembourg companies are expressly allowed by law to issue bonds under a foreign law and may disapply all provisions of the Luxembourg Law of 10 August 1915 on commercial companies, as amended, relating to bond issuances.

The number of notes/bonds issuances on the Luxembourg Stock Exchange has increased over the last couple of years and continues to do so. There is no doubt that Luxembourg will remains *the* European market for bonds/note issuance.