

Luxembourg

Financial Assistance

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Contents

	Page
INTRODUCTION	2
GENERAL OVERVIEW	2
PRIVATE LIMITED COMPANIES	4
PUBLIC LIMITED COMPANIES	5
CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE	6

INTRODUCTION

This guide provides a high-level overview of the Luxembourg statutory rules on financial assistance as currently set out in the Luxembourg Companies Act, the law of 10 August 1915 concerning commercial companies, as amended (the Company Law).¹

GENERAL OVERVIEW

What are the origins of financial assistance in Luxembourg law?

The rules on financial assistance were introduced into Luxembourg law (Article 430-19 of the Company Law) through transposition of Article 23 paragraph (1) of the Directive 77/91/CEE, as amended by Article 1, paragraph 4, of Directive 2006/68/CE and repealed by Directive 2012/30/EU. A 'whitewash procedure' was added to the financial assistance rules by a law of 10 June 2009.

The Company Law itself was significantly amended by a law of 10 August 2016, which also impacted the financial assistance rules. This reform created 'simplified joint stock companies' (*société par actions simplifiées*), which are subject to the financial assistance rules. Unfortunately, the reform also created some uncertainties concerning the types of companies submitted to the financial assistance rules.

The rules were clarified by the legislator in the Law of 6 August 2021, amending the Company Law (the New Law).²

What should be understood as financial assistance under Luxembourg law?

Under Luxembourg law, financial assistance consists of the direct or indirect advancement of funds, granting of loans or provision of security by a company with a view to the acquisition of its own shares by a third party. In the absence of further statutory details, it is generally thought that:

- the prohibition applies irrespective of whether the financial assistance is granted by the target directly to the acquirer, or indirectly through a third party acting for the acquirer; and
- the prohibition applies whether the target provides assistance by means of a loan, an advance which is not necessarily qualified as a loan, or the granting of security.

Some scholars state that it does not matter whether the financial assistance is given before or after the acquisition, provided that there is a link between the assistance and the acquisition of the shares. This view is debatable.

What should not be understood as financial assistance under Luxembourg law?

Several operations are not considered to be financial assistance under Luxembourg law.

The qualification must be analysed on a case-by-case basis. Each of the following conditions must be satisfied for operations which do not fall within the scope of the financial assistance under Luxembourg law:

¹ There was a renumbering of the Company Law by the Grand-Ducal Regulation, dated 15 December 2017, coordinating the amended Law of 10 August 1915 on commercial companies. This was published in the Luxembourg Official Gazette (*Mémorial A no 1066*) and entered into force on 19 December 2017.

² This was published in the Luxembourg Official Gazette (*Mémorial A*) no 607 on 12 August 2021 and entered into force on 16 August 2021.

- the proposed operation must be justified in terms of the corporate interest of the concerned companies;
- the situation cannot be qualified as an abuse of rights; and
- the sanction of any legal violation is of criminal nature (Article 1500-7 of the Company Law).

After the aforementioned assessment, we can provide that the following operations are out of the scope of financial assistance:

Security granted by an indirect subsidiary

Granting of a direct or indirect loan, security or pledge by a subsidiary to a third party for the acquisition of the parent company's securities. The rules/limitations around financial assistance concern only the target company itself.

Debt pushdown occurring in the context of a merger

Financing of the acquisition (and securities granted) by the acquiring company. After the acquisition, there is merger between the acquired company and the acquiring company whereby the surviving company: (1) will owe the entire financing; and (2) will be able to grant security interests on the assets formerly held by the target company.

All mergers are included in this operation (simplified merger or reversed merger); other protections are provided for creditors in the context of the merger (Article 1021-3 to 1021-16 of the Company Law).

Dividend recap

A loan from a third party to finance a distribution of dividends (used to repay/create cash in order to settle the dividend claim towards the shareholders).

This also includes capital reductions and the repurchase of the company's own shares by the company, even if these funds or assets are later used to finance the acquisition of the company's shares. They are still subject to other legal requirements under Luxembourg law.

Securities granted by the target company solely for refinancing its debts

Securities granted by the target company which only guarantee the refinancing of the debt of the target company itself (in the absence of a guarantee for all or part of the acquisition price).

Securities granted on the shares of the acquiring company

A pledge over the shares of the acquiring company by its shareholders, even if the pledge is granted as security for financing the acquisition of the company's shares.

Negative security, letters of comfort and incidental expenses (without obligation of reimbursement):
This includes:

- undertakings not to dispose of certain assets or encumber them with collateral in order to maintain the corporate share capital under the legal requirement;
- letters of comfort;
- ancillary cost (due diligence) payment of a success fee not included in the scope of application; and
- acquisition and financing of other financial instruments of the target such as bonds, warrants, founders' shares, convertible bonds and subscription rights. Depending on the purposes of such acquisition or financing of such instruments, which should be global (see the real intention of the parties), they may also fall within the scope of the financial assistance, and an analysis must be made on a case-by-case basis to assess this. The assessment will depend on the real intentions of the parties, and the exclusion must be assessed in-depth to confirm the parties' intentions.

Is financial assistance accepted under Luxembourg law?

Article 430-19 of the Company Law generally prohibits public companies (*sociétés anonymes*) simplified joint stock companies, partnership limited by shares (*sociétés en commandite par actions*) and European companies (*sociétés Européennes*) – hereafter, the submitted companies – from providing financial assistance to third parties for the acquisition of their own shares. The submitted companies may however rely on the so-called ‘whitewash procedure’ to provide financial assistance, if certain conditions are fulfilled.

Article 430-19 of the Company Law is not directly applicable to private limited companies (*sociétés à responsabilité limitée*). However, since the latest reform of the Company Law in 2016, it has been arguable that they are subject to financial assistance restrictions but this issue has only recently been resolved (see next section).

The key objective of the financial assistance rules is the protection of the assets of the target, from the perspective of the creditors and minority shareholders.

Are there any exceptions under Luxembourg law as regards the general prohibition of providing financial assistance to third parties?

Articles 430-19 (2) and 430-19 (3) of the Company Law provide the following list of activities where the provision of financial assistance is not unlawful (provided that those activities will not result in the net assets of the company becoming lower than the amount of the share capital increased by non-distributable reserves):

- transactions made within the ordinary course of business of banks or other financial institutions;
- operations entered into with a view to the acquisition of shares by or for employees of the company, or of a company related to the company by a controlling relationship; and
- fully paid-up shares issued by certain investment companies with fixed capital (as defined in the Company Law) and acquired at the investor’s request by that company, or by a person acting in his own name but on behalf of the company.

What are the consequences of providing financial assistance?

The consequences of a breach of the statutory rules on financial assistance can be severe.

Civil penalties

Providing financial assistance constitutes grounds for civil liability of the directors and managers of the target company. The directors and managers may be required to compensate any person who suffered a loss as a consequence of their unlawful actions.

Interested third parties may challenge the financial assistance and obtain the nullity of the acts and actions. Such nullity will apply from the outset, and the assistance will be treated as though it had never come into existence (*ex tunc*).

Fines and criminal sanctions

Directors and managers may be held liable to a fine of €5,000 to €125,000 and/or two years’ imprisonment.

PRIVATE LIMITED COMPANIES

Before the reform of the Company Law in 2016, there was no equivalent statutory provision for private limited companies. The financial assistance prohibition and ‘whitewash procedure’ of Article 430-19 applied only to submitted companies.

In the course of the parliamentary work of the law of 2016 amending the Company Law, private limited companies were intended to be subject to the same regime as the submitted companies.

However, the approved bill did not include those amendments.

There is a certain degree of uncertainty as to the application of the financial assistance prohibition to private limited companies, given that the criminal sanctions attached to the violation of Article 430-19 still make reference to '*parts sociales*' (private limited companies shares) which are specific terms only used in the context of private limited companies.

Although this is generally interpreted as a clerical error of the legislator (who should have deleted any reference to private limited companies in relation with financial assistance), it cannot be excluded that the criminal prosecutor and/or court may take different view.

In such a scenario, private limited companies become submitted companies without a whitewash procedure being available.

The legislator has clarified the situation with the New Law by removing the term '*parts sociales*'. Now, there is no equivalent statutory provision for private limited companies; the financial assistance prohibition and 'whitewash procedure' of Article 430-19 only applies to submitted companies.

As a result of this amendment, the references to '*part sociales*' and the superfluous reference to public limited companies have been deleted from Article 1500-7 of the New Law, thereby clarifying that the regime of rules relating to financial assistance was not applicable to limited liability companies.

This amendment, made necessary by the passage of time, should put an end to the difficulties of interpretation among practitioners and to the debates resulting from this material error.

PUBLIC LIMITED COMPANIES

General rules

Article 430-19 of the Company Law provides that a company may not directly or indirectly advance funds or make loans or provide security with a view to the acquisition of its own shares by a third party.

Exceptions to the applicability of the general rule as regards public limited companies

The exceptions to the general rule are listed above. Moreover, under the Company Law, submitted companies may provide financial assistance if it complies with the following provisions of Article 430-19 – the so-called 'whitewash procedure':

- The management body must assess:
 - the corporate interests of the company;
 - the consideration (which must be at arm's length and at fair market value) to be received by the company in exchange for the loans and advances made; and
 - the financial situation of the acquirer and other third parties involved in the transaction.
- The management body must prepare a written report explaining:
 - the purpose and interest of the transaction for the company;
 - the risks involved in the transaction for the liquidity and solvency of the company; and
 - the proposed purchase price for the shares of the company.This needs to be submitted to and approved by the general meeting.
- The report of the management body must be filed with the Luxembourg trade and companies register, and published on the *Recueil électronique des sociétés et associations* and will be presented to the general meeting for their prior approval.

- The general meeting of shareholders must approve the transaction, based on the above report, with a majority vote of at least two-thirds of the votes cast at a meeting where at least half of the share capital is present.
- The company must have distributable reserves at least equal to the value of the financial assistance granted, which will in consequence be blocked and become non-distributable reserves.

The above interdiction and whitewash procedure shall not apply to transactions concluded by banks and other financial institutions in the normal course of business, or to transactions effected with a view to the acquisition of shares by or for the company's employees or by a company linked to such company by a controlling relationship. However those transactions may not have the effect of reducing the net assets below the amount of the subscribed capital plus any reserves which may not be distributed by law or under the articles of association.

CONSEQUENCES OF PROVIDING FINANCIAL ASSISTANCE

Civil penalties and liability of the administration body

Luxembourg doctrine considers that the advancement of funds, granting of loans or the provision of securities by a company with a view to the acquisition of its own shares by a third party may be considered null and void by law.

While Luxembourg case law does not exist on this matter, Luxembourg doctrine adheres to Belgian case law – whereby the prohibition on the provision of financial assistance is a matter of public order. Therefore, any interested third party may seek the nullity of the contract. This nullity would apply *ex tunc* and may affect all acts resulting from the challenged financial assistance. The members of the management body of the company may also be held civilly liable for management error.

Article 441-9, section 2 of the Company Law provides that a director shall be liable to the company and third parties if the company or third parties suffer a loss due to an infringement of the Company Law, such as the provisions on financial assistance. The liability is joint and several among all members of the board of directors; all directors are presumed to be liable. This is also applicable to managers of private limited companies, by virtue of Article 710-16 of the Company Law submitting managers to the same rules mentioned at Article 441-9, section 2.

Both the company and third parties (eg creditors, a receiver in bankruptcy representing all creditors, shareholders, etc) have a right of action against directors who have committed a breach of the Company Law.

Fines and criminal sanctions

Article 1500-7 of the Company Law provides that any person who, in their capacity as director of a public limited company or manager of a private limited companies, knowingly made loans or advances using company funds on shares or other interests in the company contrary to the provisions on the prohibition of financial assistance shall be subject to:

- a jail term of one month to two years; and/or
- a fine of €5,000 to €125,000.