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Luxembourg: Trends and Developments

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Introduction

In the aftermath of World War II, the Grand Duchy of Luxembourg ("Luxembourg") has seen significant and consistent economic growth due mostly to its political stability, social tranquillity, and central location in Europe.

In addition, despite being a small nation, Luxembourg, as one of the founding member states of the European Union (EU), has actively participated in its formation, allowing it to be at the forefront of numerous European reforms, particularly in the financial and economic sectors.

Combined with a business-friendly attitude, Luxembourg became a leading financial centre in the world. Luxembourg is the largest financial centre for investment funds in Europe and the second largest in the world (second only to the United States).

Moreover, Luxembourg is the country of choice for private equity firms to establish their investment platform for acquisitions.

Luxembourg's prominent position as a financial centre and hub for private equity firms provides the nation with a unique opportunity to monitor the most recent trends and advancements in M&A activity.

Market Activity Overview

As an internationally oriented economy, Luxembourg has not been immune to the global slowdown in M&A deal activity.

In an economic climate where high interest rates have increased the financing costs of any acquisition, particularly for private equity firms that heavily rely on financial leverage, Luxembourg has generally witnessed a slowdown in its M&A activity.

Nonetheless, the Luxembourg M&A market experienced notable acquisitions, especially in the finance sector. Without being exhaustive, we might briefly mention the following acquisitions:

- the acquisition by Deutsche Börse of all the outstanding shares of the leading digitised fund distribution platform FundsDLT;
- the acquisition by General Atlantic of Actis;
- the acquisition by BTG Pactual of FIS Privat-Bank S.A.; and
- the acquisition by Cinven of a majority stake in Alter Domus.

In terms of deal structuring, with the advent of new market conditions, parties tend to structure their deals so as to minimise the amount of cash to be disbursed. Thus, vendor loan notes are

being used relatively often, and there has been a resurgence in the use of earn-out clauses. Completion accounts are also being used more frequently to bridge the valuation gap between buyer and seller.

Legal Developments and Their Impact on the Corporate and M&A Environment

Clarifications to the 1915 Law

The law of 10 August 1915 on commercial companies (the "1915 Law") has been built on the difficult balance of two fundamental principles: the freedom given to the shareholders and the protection of third parties. Faithful to this long tradition, the 1915 Law was subject to a major reform in 2016 (the "2016 Reform") to modernise it.

Despite the great efforts made by the drafters of the draft bill of the 2016 Reform, a certain number of errors and inconsistencies were revealed by the practice thereafter. It appears necessary to rectify them.

The bill of law No 8007 (the "8007 Bill") was introduced to the Parliament on 6 May 2022, with the aim of clarifying the inconsistencies, correcting the clerical errors or omissions, and updating the definitions and references to laws that have changed or were repealed since the 2016 Reform.

The 8007 Bill was adopted by the law of 7 August 2023 (the "Clarification Law") which became effective on 22 August 2023.

A key focus in the M&A context is the clarification brought by the recent Clarification Law to the pre-approval procedure existing for private limited liability companies (SARLs) in the event of a transfer of shares to a third party.

Article 710-12 of the 1915 Law provides that any transfer of shares of a SARL to a third party is subject to the prior approval of shareholders representing at least three-quarters of the shares or half of the shares if the articles of association of the company allow it.

If the transfer is approved, the transfer is completed. If the transfer is refused within the three months following the date of refusal, the other shareholders can acquire the shares of the transferor, or the company may also reduce its share capital through the repurchase and cancellation of the shares of the transferor. If, at the expiration of such a period of three months, no action has been taken by the company or the shareholders, the transferor will be in a position to transfer his/her shares to the original third party.

Article 710-12 being of public order, it is not possible to circumvent such pre-approval. Consequently, practitioners are under the obligation to carefully check the compliance of such a requirement before any acquisition of shares of a Luxembourg SARL; otherwise, the validity of such an acquisition may be called into question.

The former Article 710-12 referred to the refusal of the company to consent to such a transfer. Such wording could cause confusion since it could lead one to believe that in addition to the approval of the shareholders, the approval of the management body of the company was required. The Clarification Law removed the reference to the company and the current Article 710-12 now only refers to the consent being refused.

Another clarification introduced by the Clarification Law is at the level of the repurchase of the shares in the event of a refusal. The mention that such repurchase requires the consent of the transferor has also been removed. Indeed,

the transferor, by prohibiting the company from repurchasing its shares within the three-month period fixed by the law, could be in a position to transfer them to the original third party despite the refusal of the shareholders.

It was also clarified that the repurchase of the shares can be followed or not by a cancellation of those shares.

It is difficult to provide an exhaustive list of all the clarifications addressed by the Clarification Law. However, it is worth mentioning the following points from a corporate and M&A perspective.

The Clarification Law cleared up an ambiguity resulting from the exclusion of SARL as a sole shareholder under certain provisions governing SARL under Article 710-28 of the 1915 Law. Thus, the Clarification Law made it clear that for a SARL, no pre-approval is required in the event that the shares of the SARL are held by a single shareholder. Similarly, the Clarification Law expressly indicated that a SARL with a sole shareholder can have an authorised share capital, and that the management of such a SARL can transfer the registered office of the company within the same city or from one city to another.

In the event of a SARL's liquidation, the Clarification Law eliminated the existing double majority in terms of headcount and share capital. Thus, a liquidation is now approved with the consent of shareholders representing three-quarters of the capital. It is no longer necessary to also have the consent of half of the shareholders.

Lastly, in terms of voting rights, we noted an alignment of the regime between the public limited liability companies (SAs) and the SARLs. The Clarification Law set forth that the shares with suspended or waived voting rights in a SARL or an SA are not taken into account in the determination of the conditions of quorum and majority voting rights. Likewise, following the example of the SA, it has been clarified that repurchased shares of a SARL are not considered in the determination of the conditions of quorum and majority voting rights.

Emergence of a competition law in Luxembourg

On 24 November 2022, the Luxembourg Parliament adopted a new law on competition, which came into force on 1 January 2023 (the "Competition Law").

The Competition Law transposed Directive 2019/1 of the European Parliament and the Council into Luxembourg law with the aim of strengthening the independence of the Luxembourg national competition authority and its investigating and fining powers.

The Competition Council (*Conseil de la concurrence*) changed its name to the National Competition Authority (*Autorité de la concurrence du Grand-Duché de Luxembourg*) and became an "*établissement public*" (ie, a legal person governed by public law with financial and/or administrative autonomy).

The Competition Law did not establish a national merger control regime in Luxembourg. Indeed, Luxembourg is the last member of the European Union that does not dispose of a national merger control regime. Currently, the powers of the National Competition Authority are limited to an ex post intervention allowing it to sanction a merger in case such merger constitutes an abuse of dominant position.

Nonetheless, following the positive reception of a public consultation launched by the Ministry

of Luxembourg on 20 January 2022, the Ministry of Economy introduced the bill of law No 8296 (the “8296 Bill”) to the Luxembourg Parliament.

In a nutshell, the 8296 Bill aims to create an ex-ante regime. The National Competition Authority will review the merger before such merger is completed. For this purpose, the undertakings exceeding specific turnover thresholds mentioned in the 8296 Bill will be required to notify the National Competition Authority of their intended mergers. Throughout the evaluation carried out by the National Competition Authority, a standstill obligation will be imposed on the merging parties, prohibiting them from proceeding with the merger until the National Competition Authority has completed its assessment. The 8296 Bill also considered the peculiarities of the Luxembourg financial market by excluding from its scope transactions involving companies in the financial and banking sector under certain conditions. As a result of recent governmental changes, there is no information for the moment on the anticipated implementation date of the 8296 Bill or the likelihood of substantial amendments to the 8296 Bill.

In light of the foregoing, it appears that the Competition Law and the introduction of Bill 8296 could be seen as the first steps in future developments in competition law. The new organisation and expanded powers of the National Competition Authority will be key components of its enforcement regime.

While the volume of deals involving Luxembourg-based operating companies may be smaller compared to larger jurisdictions, such as Germany or France, the emergence of a comprehensive competition law may still have a notable impact on domestic M&A transactions in the future.

Digitalisation of the incorporation of companies

In an effort to promote the growth of digital tools and simplify the administrative procedures to enhance the attractiveness of Luxembourg’s financial centre, the Luxembourg Parliament adopted the law of 7 July 2023 which transposes the Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 on the use of digital tools and processes in company law (the “Digitalisation Law”). The Digitalisation Law came into force on 1 August 2023.

The main changes introduced by the Digitalisation Law include:

- Luxembourg notaries can now draw up deeds and authentic instruments electronically, with the exception of wills.
- It is now possible to incorporate SAs, SARLs and corporate partnership limited by shares (SCAs) online, without the need for a physical appearance.
- Online incorporation can be carried out using standard articles of association provided free of charge by the Notaries’ Chamber.
- The capital must be paid in cash electronically, and proof of payment can also be provided electronically.
- Online incorporation by way of in-kind contributions is not possible.

Modernisation of the insolvency law

On 19 July 2023, the Luxembourg Parliament adopted the law of 7 August 2023 on business preservation and modernisation of bankruptcy law, which entered into force on 1 November 2023 (the “New Insolvency Law”). The New Insolvency Law modernises the previous insolvency proceedings by introducing new preventive reorganisation procedures to help financially distressed companies preserve and ensure the

continuity of their business without the risk of bankruptcy. The new preventive reorganisation procedures introduced by the New Insolvency Law could potentially generate corporate work in their implementation and accordingly have an impact on M&A activity in Luxembourg.

The upcoming transposition of the Mobility Directive

In a bid to modernise and simplify company law rules across the European Union, the European Parliament and the Council adopted Directive (EU) 2017/1132 related to certain aspects of company law (the "Company Directive").

The Company Directive established provisions for cross-border and domestic mergers. Nonetheless, the company directive did not provide any provisions in connection with cross-border divisions and cross-border conversions. To realise cross-border divisions and conversions, Luxembourg practitioners have to date relied on a distributive application of the laws of the relevant member state involved in the transactions.

To fill the legal void left by the Company Directive, on 27 November 2019, Directive (EU) 2019/2121 (the "Mobility Directive") was adopted by the European Parliament and the Council.

The Mobility Directive amended the Company Directive to improve the current regime applicable to cross-border mergers and introduced new provisions for the harmonisation of cross-border divisions and conversions.

The Mobility Directive aims to facilitate cross-border company mobility while strengthening stakeholder protection.

Nonetheless, by creating new mechanisms of protection, such as the introduction of anti-abuse control, an exit right for shareholders, or the requirement of a management report addressed to employees, the Mobility Directive may ultimately have the opposite effect of the one intended. The implementation of these mechanisms will increase the workload and administrative costs for companies and be cumbersome, especially in the event of intra-group reorganisations.

The deadline for the implementation of the Mobility Directive was 31 January 2023. In this regard, Luxembourg introduced Bill No 8053 (the "8053 Bill") on 27 July 2022, to implement the Mobility Directive. Even though the deadline for transposing the Mobility Directive has passed, the 8053 Bill is still undergoing the parliamentary process, and additional modifications are possible. There is currently no announced date for its adoption.

Due to the potential negative effects on business that the new rules introduced by the Mobility Directive may have, the Luxembourg legislature has decided to adopt a minimalist, selective approach to its implementation.

The goal of the 8053 Bill is to simplify and improve the current regime where possible and to implement all mandatory provisions but not more than is necessary. The optional provisions of the Mobility Directive will only be transposed if they are favorable towards facilitating corporate mobility.

The 8053 Bill set up two regimes: a general regime applying to domestic transactions and cross-border transactions between a Luxembourg company and a non-EU company, and a special regime applying to cross-border transactions between a Luxembourg company and an EU company.

The general regime does not significantly diverge from the current applicable regime, so we do not anticipate any major changes from the existing practice. In contrast, the introduction of the special regime represents a more substantive shift that will have a major impact on how these transactions are handled in the Grand Duchy. Accordingly, there will be a period of adaptation during which Luxembourgish practitioners will need to adapt their approaches and processes to this new set of rules and requirements.

Main innovations introduced by the 8053 Bill

Since its introduction in 2013 in the Luxembourg legislative framework, the special limited partnership (*société en commandite simple spéciale* – SCSp) has seen significant success, notably in the funds industry. However, the absence of legal personality previously prevented SCSps from carrying out domestic or cross-border mergers or divisions. Aiming to further strengthen the attractiveness of the SCSp, the 8053 Bill has now extended the scope to allow these entities to participate in such transactions. This eliminates the need for an SCSp to first transform into a limited partnership (*société en commandite simple* – SCS), reducing both costs and delays.

The 8053 Bill introduces a new mechanism aimed at simplifying corporate reorganisation. Moving forward, it will be possible to execute side-stream mergers within the context of a merger by absorption without the requirement of issuing shares. Under this legislation, companies directly or indirectly owned by the same entity or shareholders in identical proportions will be eligible for such side-stream mergers. This provision applies to both domestic and cross-border transactions.

As mentioned earlier, the 8053 Bill will strengthen the rights of shareholders in the three categories of cross-border transactionsaimed by the special regime by introducing an exit right for shareholders. Shareholders involved in transactions within the scope of the general regime will not be granted such an exit right. The opportunity to withdraw will apply to shareholders who voted against the approval of an international transaction. They will be permitted to sell all of their voting shares in exchange for a cash payment to be made within two months of the transaction's effective date. A partial exit is not possible. Non-voting shares and beneficiary shares (*parts bénéficiaires*) will not have access to the exit right. Similarly, the exit right will not apply to shares that have been transferred between the date of publication of the cross-border transaction proposal and the date of the cross-border transaction's general meeting.

The 8053 Bill will also introduce a new control of legality. The completion of the cross-border transaction will require the prior issuance by the notary of a certificate. This certificate will only be granted if the notary determines that all conditions, formalities, and procedures related to the cross-border transaction have been fulfilled, and that the transaction is not manifestly intended for abusive, fraudulent, or criminal purposes. However, there are practical concerns regarding the notary's ability to assess the potentially abusive, fraudulent, or criminal nature of the transaction. This task may exceed the current scope of the notary's authority, posing challenges in its implementation.

An additional noteworthy innovation pertains to the requirement for the management body of the relevant company to prepare a specialised report for both shareholders and employees. This report will explain and justify the legal and economic aspects of cross-border transactions, while also explaining the implications of

such transactions for employeesand, in particular, for future operations of the company. The report must be addressed to both shareholders and employees, either in a single report with two different sections or in two separate reports. There are some exceptions. The shareholders can decide to waive the report addressed to them. Likewise, the report addressed to the employees can be omitted if the company or its subsidiaries have no employees other than the members of the management body. While this exception might seem applicable, Luxembourg's prevalence of holding companies within groups makes it unlikely a company will not have indirect subsidiaries with employees at some level.

Looking Forward

Fortunately, 2024 holds promise for brighter prospects compared to the preceding year. There is a noticeable resurgence of optimism among various economic market participants. The halt or deceleration in inflation gives hope that the central banks will lower their key rates in the coming months, or at the very least no longer raise them. Stable interest rates could foster a favourable environment for renewed economic activity. If buyers can predict with a certain degree of certainty their deal costs, they may be more inclined to pursue their acquisitions even though their financing remains expensive.

Moreover, potential sellers are beginning to adjust to the new market conditions and are willing to make concessions in terms of valuation prices. Conversely, prospective buyers, encouraged by the current decrease in valuation prices, perceive an opportune moment to seize favourable acquisition prospects. Consequently, the valuation gap between buyers and sellers is narrowing.

Private equity firms have amassed significant dry powder in recent years, obliging them to deploy their capital in the foreseeable future. A portion of their fees hinges on investment deployment. Conversely, private equity firms are increasingly under pressure from investors to devise exit strategies for their portfolio companies, as investors grow impatient to see returns on their invested capital. In this regard, following the robust valuations observed in the equity public markets, IPOs once again emerge as a viable exit strategy.

Market conditions are ripe for a pickup in M&A activity. Several positive indicators point towards a surge in deal making in the months ahead. The second half of 2024 could see a return to business as usual in the M&A market.

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