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Newsletter Q1 2018

Recent significant corporate litigation case law

The Luxembourg has recently ruled on two interesting aspects of corporate litigation.

Decision of the Luxembourg District Court of 18 November 2016 on judicial management report

The Luxembourg District Court had the opportunity to specify the requirements and procedure of the judicial management report provided for in article 1400-3 (previously 154) of the law of 10 August 1915 on commercial companies as amended.

It can first be recalled that the new version of the article 154 introduced by a Law of 10 August 2016 had significantly extended the conditions allowing shareholders to initiate a judicial management report procedure (see our Newsletter Q3 2016).

In its decision, the Court ruled, on the basis of the criteria established by the French case law, that there is no need to order a judicial management report as long as the answers provided to the shareholders by the board of directors, even after the legal action has been initiated, include all the information that can be expected and are thus satisfactory.

The Court also specified that questions of the shareholders may only address matters falling within the power of the management bodies and not operations falling within the power of shareholders' meetings, even when effected by the management bodies.

Moreover, a question may address several issues, as suggested by the use of the plural form of “operations” in the law. However, a question should not address management or accounting in general.

Finally, questions concerning future projections but unrelated to an existing act of management are excluded.

This ruling provides valuable insight into the right of shareholders to request information on management decisions. While the decreased threshold suggested a trend in Luxembourg law towards shareholders’ empowerment as well as accountability and transparency of the managing bodies, the present ruling appears pro-management.

It shields management from unwarranted intrusions by setting an arguably low standard of disclosure and limiting the scope of the shareholders’ inquiries to pure and specific managerial issues.

Decision of the Luxembourg District Court of 12 July 2017 concerning the conditions for the enforcement of a pledge

Further to the decision of the Luxembourg District Court, collateral consisting in a pledge over shares of a company can be enforced even without any payment default, i.e. even if the secured debt is not due and payable.

In fact, under Luxembourg law, the parties may freely agree over the triggering event (in the present case non-compliance with a binding financial ratio), notably as article 1(6) of the Law of 5 August 2005 on financial collateral arrangements provides that “*any other event agreed by the parties*” can activate and render the pledge enforceable.

Hence, it is sufficient that one party notifies the other that the latter breached the related contractual clause.

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Overviews of the new corporate governance rules after the adoption of the Law on Modernisation

The law dated 10 August 2016 (the "**Law on Modernisation**") which modernised the companies law dated 10 August 1915 (the "**Companies Law**") significantly modified the corporate governance rules related to the private limited companies (*société à responsabilité limitée* "**SARL**") and the public limited liability companies (*sociétés anonymes* "**SA**") and also incorporated into the Luxembourg law a new legal form, the simplified joint stock company (*société par actions simplifiée* "**SAS**"), which allows much flexibility as the corporate governance rules are mainly determined in the articles of association (the "**Articles**"). The major changes (provided that SAS is excluded from this publication) are the following:

Management rules and authority

- With respect to SARL: possibility
  - to provide in the Articles an authorised share capital mechanism;
  - to delegate the daily management of the company to one or several day-to-day managers.
- With respect to SA: possibility
  - to delegate some specific tasks to a management committee (*comité de direction*) or a managing executive officer (*directeur général*) (excluding the matters relating to the general policy of the company and all actions expressly reserved to the board by the Companies Law) which remains under the supervision of the board or the management board;
  - for the board or the management board to create *ad hoc* committees which also remain under the supervision of the board or the management board.
- With respect to SA and SARL:
  - possibility to transfer the company's registered office from a municipality to another by a mere decision of the board.

Company meetings

- With respect to SARL:
  - the maximum number of shareholders is now 100;
  - any *inter vivos* transfer of shares to a non-shareholder requires the approval of the shareholders representing at least 75% but the Articles may lower this majority down to 50% of the share capital;
  - abolition of the double majority system for any decision amending the articles of association (decisions are now taken by shareholders representing at least 75% of the share capital);
  - general meetings are not compulsory where the number of shareholders is less than 60. Articles may allow any shareholder to cast its vote by mail using a voting form.
- With respect to SA:
  - the Articles no longer have to determine the specific date and place for the annual general meeting;
  - the board of directors, management board, supervisory board (if any) and the internal auditors (*commissaires*) may all convene a general meeting. Shareholders representing at least 10% of the share capital may also require the board to convene the general meeting;
  - if, as a result of losses, net assets fall below half of the corporate capital, the board of directors or the management board must convene the general meeting in order to resolve on the possible dissolution of the company and possibly on another measures announced in the agenda. The board or the management board shall set out the causes of the situation and, as the case may be, propose measures to remedy the financial situation of the company in a special report which is made available to the shareholders before the general meeting.
- With respect to both SA and SARL:
  - the company's nationality may be changed without the unanimous consent of the shareholders;
  - each shareholder may take part in collective decisions irrespective of the number of shares they own. Unless shares are issued without voting rights, each shareholder has voting rights commensurate with its shareholding.

Where shares do not have an equal value, or where there is no indication of value, each share (unless otherwise provided for in the articles) will carry the right to a number of votes proportionate to the share capital represented by it with one vote being allocated to the share that represents the lowest proportion;

- shareholders may waive their voting rights temporarily or definitively;
- the management body can suspend shareholder's voting rights where there has been a breach of provisions of the Articles or any separate agreement;
- voting arrangements are allowed subject to specific conditions;
- shareholders representing at least 10% of the share capital may ask for a prorogation of a general meeting (formerly 5%).

Shareholders' inspection in SA and SARL (*expertise de gestion*)

Shareholders representing at least 10% of the share capital may ask the management body questions in writing on one or more acts of management of the company or its subsidiaries. In the absence of an answer these shareholders may apply to the judge to appoint an expert who will issue a report on these acts of management (*expertise de gestion*).

For any further information and details on the above, please refer to the following article: https://uk.practicallaw.thomsonreuters.com/Document/I56aa13efc34a11e498db8b09b4f043e0/View/FullText.html?transitionType=CategoryPageItem&contextData=%28sc.Default%29&navId=C33FA475429CE319026ED96F97316AEC&comp=pluk

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Overview on the put and call options rights in Luxembourg

The provision of put and call options clauses has become a common business practice in order to protect shareholders' interests. That is why we propose you a recap of the main features and interests of such options (1), as well as an overview of key issues in practice (2).

1. Main features and interests

Put options

The purpose of a put option is to grant its beneficiary with a right to sell securities (generally, shares of a company) in accordance with predetermined conditions. The other party to such an agreement, i.e. the buyer takes the engagement by advance to purchase the securities upon exercise of the option by the beneficiary. The interest of put options is to facilitate the sale of their participation in a company at a secured price. A put option provides a safety net for a potential seller by guaranteeing a determined or determinable exercise price on a certain period.

Call options

On the other hand, a call option agreement grants its beneficiary with the right to purchase securities at predetermined conditions. The other party i.e. the seller takes the engagement in advance to sell the securities upon exercise of the option by the beneficiary. Call options can be used as a guarantee. It may also be an interesting tool in the context of the issuance of shares to employees as an incentive measure, as it allows to "call" back such shares in the case where the employees resign. It can also be used in joint ventures as a method to resolve deadlock situations: the beneficiary of an enforceable call right against another dissenting shareholder may exercise it to acquire its shares in order to get a sufficient majority to unlock a situation.

2. Key issues in practice

Even if call and put options are practical tools, their implementation may raise some issues. Below is an overview of key questions in practice and some tips to avoid the main pitfalls.

Transferability of the shares subject to the option

The exercise of a put or call option always involves a transfer of shares. Therefore, it is advised, before to conclude an option agreement, to address the conditions applicable in order to validly transfer such shares e.g. existence of transfer restrictions (pre-emption rights, …) or particular applicable formalism (prior approval process, …).

Representations & warranties

A particular attention should be paid to the wording of the representations & warranties which should include (among others) the authority and capacity to sell the option shares, the absence of any encumbrance and the warranty that they are fully paid-up.

Conditions of the exercise of the option

It is possible to provide that options are exercisable subject to the occurrence of a specific event or condition. In such a case, it should be specified accurately the scope and the deadline to fulfil each condition, the party responsible and the consequences in case of failure.

To minimize the risk of dispute, the possibility to exercise partially or not the rights (e.g. on a portion of the option shares only) or the possibility of an early exercise should also be addressed.

In case of crossed option rights, it is common practice to provide that the put option right may be first exercisable by the minority shareholder; if it is not, then the majority shareholder will have the right in turn to exercise its call option.

Price of the exercise of the option

The price of exercise of the option may either be fixed or determinable in advance in accordance with a pre-agreed formula. In the latter situation, disputes between parties may arise in case of disagreement on the final calculation of the price.

To avoid it, the method of calculation of the final option price should be provided as precisely as possible. If the parties cannot find common ground, the appointment of an expert may be necessary in order to settle the matter. It could thus be helpful to provide for a specific clause in order to outline the appointment process of the expert in case of disagreement (e.g. the expert must be an independent third party with certain qualifications; and/or the candidate has to be proposed by one of the parties and approved by the other one). An independent expert may also be directly named.

Specific performance

The Luxembourg case law, based on the prevailing French case law, considers that the remedy to a breach of an undertaking to do is damages only i.e. it cannot in principle be subject to specific performance.

This being said, the French Supreme Court has also expressly validated the principle of specific performance clauses in option agreements.

Thus, if expressly mentioned in the option agreement, it is likely that a Luxembourg court would grant the specific performance in case of breach of its undertakings by the debtor.

Forfeiture clause

It could also be considered whether a forfeiture clause could be useful, in order to grant the potentially aggrieved party with the payment of a fixed amount. As opposed to a penalty clause, a forfeiture clause cannot (in principle) be reduced by a Court. The difference between these clauses is that for the first one, the debtor committed a breach of its obligation; for the second one, the debtor is buying its liberty to get out of its contractual obligations.

As a final general remark, the replication of the put / call options provisions (if not confidential) in the articles of association (publicly available) may enhance their enforceability toward third parties. For the same purpose, we also recommend mentioning the existence of the put or call option directly in the company's share register.

If you need any complementary information, please feel free to contact:

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CSSF's change of policy regarding UCITS eligible investments

On 5 January 2018, the CSSF has issued a press release ("**Press Release 18/02**") to announce its change of policy regarding UCITS funds investing in other undertakings for collective investments ("**UCI**"), including non-UCITS exchange-traded funds.

1. New regulatory position

The CSSF provides in Press Release 18/02 that the eligibility criteria of such target UCI ("**Target UCI**") under Article 50(1)(e) of the UCITS Directive should be assessed on the basis of the fund documentation. Consequently, mere compliance controls or written confirmation of the relevant Target UCIs (or of their managers), as previously mentioned in the Frequently Asked Questions relating to the Law of 17 December 2010 on UCIs (the "**FAQ**"), shall no longer be sufficient.

In particular, the CSSF wishes to draw attention to the fact that for Target UCI to be deemed eligible investments for a UCITS fund, such Target UCI should comply with the following criteria:

(i) They shall be prohibited from investing in illiquid assets (such as commodities and real estate);

(ii) They shall be bound by rules on asset segregation, borrowing, lending and uncovered short selling;

(iii) The constitutive documents shall include a restriction for investments in other funds to 10% of the net assets of the relevant Target UCI.

2. Compliance requirements

As a consequence, the CSSF has updated its FAQ to delete the previous FAQ 1.4 and published a new version 5 of the FAQ dated 5 January 2018.

As detailed in Press Release 18/02, the CSSF further requires all UCITS funds having invested in Target UCI according to the previous policy laid down in FAQ 1.4 to disinvest from these Target UCI as soon as possible, taking into account the best interest of investors.

The CSSF shall contact the managers of all relevant UCITS by 31 March 2018 in order to check compliance.

For the avoidance of doubt, the CSSF also underlines that new investments into Target UCI according to this previous policy are no longer allowed.

Press Release 18/02 is available on the CSSF's website.

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The new Law on commercial lease (Part 1: scope of the Law and new restrictions)

The law of 3 February 2018 on commercial lease and amending certain provisions of the Civil Code (the "**Law**") has come into force on 1 March 2018.

The Law is the result of the willingness of our legislator to define a new legal framework which is supposed to avoid dysfunctions resulting from speculative practices in the commercial real estate market. In fact, the few existing provisions dating from 1936, which already aimed at preserving the business assets of the retailers (*fonds de commerce*), turned out to be too liberal for an economic activity in need of more stability.

Undoubtedly, this Law constitutes a revolution in the Luxembourg real estate landscape. We will therefore address this substantive change in three newsletters. In the present newsletter, we will focus on the scope of application of the Law as well as on the new prohibitions and restrictions[1].

The application scope of the Law

The substantial application scope of the Law

In accordance with the new article 1762-3 of the Civil Code, a commercial lease is defined as a lease intended for the exercise of a commercial, industrial or craft activity. The Law will apply uniformly to all those leases.

It is to be noted that if the Law does not specify the meaning of "commercial, industrial or craft activity", some clarifications can however be found in the Law's preparatory works such as the exclusion of banks or office premises from the scope of application.

[1] the new rules concerning the occupation period (termination, renewal, suspension to eviction and right of preemption) will be the subject of the next newsletter.

However, the legislator has specifically excluded from the scope of the law, commercial leases with a term of up to one year to prevent the Law from becoming an obstacle to ephemeral marketing activities such as "pop-up" and "concept" stores.

The temporal scope of the Law

Almost all provisions of the Law are immediately applicable to future and ongoing contractual relationships. This is uncommon and contrary to the principle of non-retroactivity of the law. We therefore anticipate that this provision will give rise to practical difficulties.

The prohibitions and restrictions introduced by the Law

On the rental guarantee

The amount of the rental guarantee is now capped to 6 months' rent and the lessor cannot refuse a rental guarantee taking the form of a first demand bank guarantee, an insurance or any other equivalent guarantee.

On rent supplements paid at the conclusion of the lease ("pas de porte")

The "key money" practice consisting in the payment of a sum of money to the lessor or to an intermediary by the lessee as an entry fee at the beginning of the lease is now prohibited by Article 1762-5 (1) of the Civil Code. Any payment made in this respect shall be refundable.

According to the legislator, this restriction is justified by the need to reduce the investment effort of the retailers, to improve the economic viability of their businesses, reduce the number of early bankruptcies and facilitate the access to the rental market and the creation of new businesses.

Logically, the Law provides that this restriction shall not apply to ongoing lease.

On sublease and lease assignment

The sublease or the assignment of the lease agreement is admitted, either if it has not been prohibited by the lessor in the lease agreement, or, in any case, if it is made together with the transfer of the business activity and if the lessor has no good reason to refuse.

The Law also requires the lessee to notify to the lessor a copy of the transfer or sublease agreement and above all provides that the sub-rent shall not exceed the rent of the principal lease, except in case specific investments have been made by the lessee for the purpose of its activity. The idea here was again to break the speculative practices consisting in taking premises to sublease them at a higher rent. This sub-rent limitation will be applicable to future and ongoing contractual relationships only from 1 March 2019.

Finally, the Law prohibits any stipulation forcing the lessee to use a specific intermediary for sublease or assignment of his lease.

These new legal restrictions represent some paradigm shift in the Luxembourg retail real estate market and lessors and tenants are advised to be vigilant particularly with respect to the changes that will apply to their current contractual relationships.

We are at your disposal if you have any questions about the Law, including matters not covered in this newsletter.

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