Luther.

Luxembourg

Law dated 10 March 2014 introducing the European Cooperative Society ("SCE") in the Luxembourg legal framework

Legal cases on financial collateral arrangements, one-sided jurisdictional clause and bankruptcy implications

Revision of collateral rules in ESMA's guidelines on ETFs and other UCITS issues

CSSF and ESMA / AIFMD related developments

Newsletter Q1 2014

Avocats à la Cour

Law dated 10 March 2014 introducing the European Cooperative Society ("**SCE**") in the Luxembourg legal framework

The regime of the SCE has been set-out by the Council Regulation n° 1435/2003 on the Statute for a European Cooperative Society which is the result of the Council's acknowledgement of a need in the European Union for trans-national cooperatives that could be initiated by people or companies residing in different Member States and governed by common principles (the "**SCE Regulation**").

Main features of the SCE

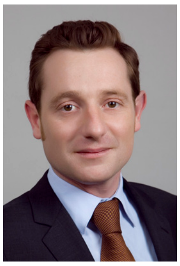
The main characteristics of the SCE, deriving from the SCE Regulation which provides the general framework applicable to SCE, are as follows.

Incorporation		The SCE may be either incorporated by members or result from the transformation or merger of existing cooperatives companies.
Corporate object		An SCE shall have as its principal object the satisfaction of its members' needs and/or the development of their economic and social activities.
Capital		The subscribed share capital of the SCE shall be of at least EUR 30,000.-. Above this amount the share capital of the SCE is variable.
Management		One tier (with a board of directors) or two tier (with an executive board and a supervisory board) systems possible.
Membership	***Investors***	The shares of the SCE shall be offered to user members (i.e members who would use or produce the SCE's goods and services).
	Liability	The liability of the SCE's members is limited to their contribution to the share capital of the SCE unless the articles of association of the SCE, at incorporation, provide otherwise.
	Voting rights and general meetings	▪ The voting rights of the members may be commensurate to their participation in the activities (and not capital) of the SCE, within the limit of statutory caps. Each member shall be entitled in any case to at least one vote regardless of the number of shares it holds in the SCE. ▪ Where the SCE undertakes different activities or activities in more than one territorial unit, or has several establishments or more than 500 members, its articles of association may provide for sectorial or section meetings.
	Disclosures	Any person justifying of a legitimate interest may access to the entirety of the register of members of the SCE.
	Exclusion	Members may be excluded from the SCE under certain circumstances.
	Economic Rights	▪ The articles of association of the SCE may provide for the payment of a dividend ("*ristourne*") to members in proportion to their business with the SCE, or the services they have performed for it. The articles of association of the SCE may exclude the distribution of any distributable surplus which would remain after the payment of dividends ("*ristournes*"). ▪ The net assets of the SCE (i.e. the residual assets remaining after payment of all amounts due to creditors and reimbursement of the members' capital contributions) which would be available after its liquidation should be distributed in accordance with the principle of disinterested distribution unless the Member States provide otherwise in their local legislation.

Even though European regulations are directly enforceable, the SCE Regulation however left some options to the discretion of Members States so that a law was necessary in Luxembourg to actually welcome this new vehicle in the local legal framework and complete the SCE Regulation which shall therefore be read in conjunction with the law of 10 March 2014 introducing the SCE and the directive 2003/72/EC on the involvement of employees which provides the rules applicable to the participation of employees' representatives to general meetings and the management of the SCE.

It should be noted that the Luxembourg Parliament has opted for the most flexible options left by the SCE Regulation and in particular allows non-user members wishing only to invest in the SCE to be admitted as well as the distribution of net assets.

This law also provides for the possibility to have members with multiple voting rights and this up to the maximum extent foreseen by the SCE Regulation which is the lower of (i) 5 votes per member or (ii) 30% of the total voting rights in the SCE (except for the members of SCE operating in the financial or insurance sector, non-user members or employees' representatives who are subject to a lower cap).



Aurélien Latouche
Partner
Luther Avocats à la Cour
Luxembourg
Phone +352 27484 680
aurelien.latouche@luther-lawfirm.com

Euryalle Didillon

Luther Avocats à la Cour
Luxembourg
Phone +352 27484 671
euryale.didillon@luther-lawfirm.com

Legal cases on financial collateral arrangements, one-sided jurisdictional clause and bankruptcy implications

The commercial section of the District Court of Luxembourg-city (the "**Luxembourg Court**") rendered late January 2014 two clear decisions comforting the current legal friendly framework of the Luxembourg financial sector (the "**Decisions**"). Those Decisions have the merit of clarifying several legal key issues, intensely debated in various other countries such as the validity of jurisdiction clauses or the status of collateral arrangements, the impact of a pending bankruptcy procedure on their enforcement as well as the legal interconnectivity which naturally arises between various transaction documents. The Decisions being analogous, the only difference being linked to the parties involved, we will therefore consider them together.

Factual background and previous legal procedures

In March 2009, several Spanish and Portuguese companies (the "**Debtors**") entered into a pledge agreement with a syndicate of banks (the "**Creditors**") to secure the obligations arising from a facility agreement (the "**Facility Agreement**"). The Facility Agreement was amended several times and the maturity date has been finally established for the end of May 2012 pursuant to an amendment agreement (the "**Amendment Agreement**").

The Creditors validly notified a pledge for perfection purposes to the bank where the relevant securities account was opened (the "**Luxembourg Account Bank**)", the Luxembourg Account Bank acknowledging the notification of the pledge in the course of the same month.

Upon failure to repay at maturity, the Creditor's agent issued to the Debtors a formal notice to reimburse the due amounts in accordance with the Facility Agreement.

In September 2012, some of the Debtors applied for bankruptcy protection in Spain and the Commercial Court of Madrid granted such bankruptcy protection one month later. Subsequently, the bankruptcy receiver (the "**Receiver**") filed a demand of *suspension of execution* for the purpose of obtaining a *restrictive injunction* on the enforcement of the pledge in accordance with the Spanish bankruptcy law. Such *interim protective measure* was granted by the Spanish court in October 2012, consequently the Receiver filed a *reintegration demand* within the frame of the bankruptcy procedure in order to obtain the annulment of the Amendment Agreement which was signed during the so called hardening period. This demand was accepted by the Spanish court and in February 2013 the Spanish judges rejected all objections submitted by the Creditors. As a consequence, the Creditors were denied the possibility of starting any enforcement proceedings against the bankruptcy protected Debtor(s), any contrary action constituting a criminal offence, according to the Spanish law.

In April 2013, the Creditors' agent notified the Luxembourg Account Bank informing that the debt was matured and given the failure of the Debtors to repay the due principal and interest, an *event of default* had to be declared pursuant to the Facility Agreement. The agent thus instructed the Luxembourg Account Bank to refrain from making any payments in connection with securities held through the securities account, i.e. the pledged shares and their related dividends.

On the same date, a majority of Creditors notified the Luxembourg Account Bank that given that an event of default had occurred, the pledge had to be considered *enforced by appropriation* pending the realization of one of the following conditions: (i) a waiver of the October 2012 Spanish court *restrictive injunction on the enforcement of the pledge*; or (ii) a decision of a Luxembourg court stating that under Luxembourg law, the pledge can be executed by the Creditors; or (iii) that the Spanish *restrictive injunction regarding the enforcement of the pledge* was not valid in Luxembourg.

The legal matters

The Creditors brought the legal action before the Luxembourg Court in order to be declared the pledge enforceable and binding against the Receiver and to be ruled that the Debtors were not able to claim any payment of dividends produced by the pledged shares and that the conditions of the enforcement of the pledge were fulfilled and that the Creditors were able to appropriate the pledged assets despite the Spanish restrictive injunction on the enforcement of the pledge.

On the other hand, the Debtors argued various means of defense justifying in their view the rejection of the Creditors' legal action, which can be summarized as follows: a *ratione loci* lack of jurisdiction of the Luxembourg courts in the light of the pending bankruptcy procedure in Spain which thus granted an exclusive jurisdiction to the Spanish courts; voidness of the jurisdictional clause provided for in the Facility Agreement arguing that this should be interpreted as a condition depending on the discretion of only one party to the agreement, as such ratione has been admitted by the French Supreme Court (*Cour de Cassation*) in a controversial decision dated 16 September 2012 (the "**French Decision**"); *lis alibi penden exception,* given the Spanish court admission of the *reintegration demand* within the frame of the bankruptcy procedure; inadmissibility of Creditors' legal action as they would merely tried to obtain a disguised enforcement of the pledge, in direct violation of the Spanish court decision based on Article 25 of Regulation CE n° 1346/2000 (the "**Insolvency Regulation**"); and finally as a *subsidiary defense on the merits* that in accordance with its contractual terms, the pledge cannot be enforced upon failure of the Debtors to reimburse the loan at maturity, but only in case of an early termination event, as such provision would have been specifically provided for in Article 23 of the Facility Agreement.

The legal solution and its argumentation

The ratione loci jurisdiction

The Creditors as plaintiffs justified the ratione loci jurisdiction of the Luxembourg Court on two grounds: (i) on the basis of the Regulation CE n° 44/2001 dated 22 December 2000 (the "**Brussels I Regulation**") where its Article 1 b excludes from its scope insolvency proceedings; and (ii) on the jurisdictional clause provided for in the pledge agreement.

(i) The Luxembourg Court noted that the European Court of Justice (the "**ECJ**") dealt with the distinction between the applicability of the Brussels I Regulation as opposed to the Insolvency Regulation. Such distinction between the scope of each text was made by the Gourdain case-law (ECJ 22.02.1979) in relation to the Brussels Convention dated 27 September 1968, "perfectly transposable" to the Brussels I Regulation. Corroborating this solution with the ECJ German Graphics case law (ECJ 10.09.2009) the Luxembourg Court retains that if a legal action is not strictly based on a provision related to bankruptcy law, it can be used independently from the opening of such procedures (...) then it finds its legal base on Brussels I Regulation and not on the Insolvency Regulation. Since the present action found its source in the pledge agreement as well as in the law dated 5 August 2005 on financial collateral arrangements, as amended (the "**Collateral Law**"), it must have been considered as a legal action which is independent from the pending bankruptcy procedures, and therefore only the Brussels I Regulation was applicable.

(ii) The Debtors argued that the *jurisdictional clause* had been drafted in such manner that gave way to an unfair balance gap in favor of the Creditors, thus penalizing the Debtors, and that a similar judiciary decision taken by the French Supreme Court declared void such clause.

The Luxembourg Court clearly delimitated itself from the French Decision by arguing, on the one hand, that there is no indication that Brussels I Regulation would have intended to prohibit such clauses. Moreover, such analysis would only be imaginable in a scenario where the weaker party needed to be protected against its counterparty, which was not the situation in the present case. The validity of such jurisdictional clause was therefore not questionable.

Pendency of proceedings (lis alibi pendens) and the connection (related cases) issue

Although the Luxembourg Court acknowledged the existence and the validity of this international public policy principle, it argued that even if the Creditors' request was subsequent to the opening of the bankruptcy proceedings in Spain, their action was not based on the existence of a debt-claim strictly speaking, but on the existence of a *right in rem*. Therefore, no such inadmissibility of Creditors legal action was recognised by the Luxembourg Court.

The Debtors continued to argue that since a procedure for annulment of the Amendment Agreement was pending in Spain, impacting the maturity date of the facility, the Luxembourg Court should have suspended its decision until the clarification of this issue by the Spanish courts in accordance with Article 27 of the Brussels I Regulation. The Luxembourg Court noted that the conditions provided for in Article 27 (i.e. identity of the cause, parties and object of the claim) were not fulfilled and therefore rejected the Debtors argumentation.

Furthermore, the Luxembourg Court stated that the parliamentary work of the Collateral Law clearly mentions the intention of the legislator of "immunization *of the enforcement of the collateral arrangements and avoid all possible incidents with this respect*". Moreover, Article 5.1 from the Insolvency Regulation provides that the opening of bankruptcy proceedings do not impact the right in rem of a creditor over the goods of a bankrupt debtor if these goods are not located in the same Member State where the bankruptcy proceedings have been initiated. The Luxembourg Court concluded that the pending bankruptcy proceedings in Spain did not impact the present Luxembourg legal action.

The subsidiary defense on the merits

Unexpectedly enough, the Debtors finally argued that in accordance with Article 23 of the Facility Agreement, the pledge was not enforceable upon the failure of the Debtors to reimburse the facility at maturity, but only in case of an early termination event.

The Collateral Law is very broad, giving to the parties the widest choice of designing the structure of a collateral arrangement, including the express contractual limitation of the situations leading to a *default*. Corroborating this logic with Article 1134 of the Luxembourg Civil Code *(i.e. valid contractual arrangements between parties represent the law between such parties)* they argued that the Collateral Law gives the parties the possibility to freely define the circumstances of the occurrence of an event of default and therefore the event of default would not necessarily be the failure to reimburse the credit. In other words, the pledge agreement would not guarantee the failure to pay at maturity, but only if an early termination event will occur.

The Luxembourg Court firstly noted that Article 2071 of the Luxembourg Civil Code defines the pledge as *an agreement pursuant to which the debtor remits a good to the creditor as security interest for the payment of its debt.* Subsequently, Article 2082 of the Luxembourg Civil Code provides that *the debtor cannot (…) require restitution of the pledged goods except upon complete payment (principal and interest) of the debt for which the pledge has been perfected.*

It results from the above that the enforcement is the main feature and even the main purpose of any pledge agreement. Moreover, the Collateral Law represents merely a special application of these general principles having as purpose the protection and the reinforcement of creditors' rights, and not the other way around (i.e. the limitation of such rights). Such phantasmagoric argumentation has therefore been ruled out by the Luxembourg Court.

The Decisions irrefutably contributed to the necessary legal stability of the financial environment. This clarification was welcomed given the troubles caused by the past global turmoil and the very debatable above-mentioned French Decision on the notion of *potestativity*, avoiding therefore a possible contamination effect over the Luxembourg courts.

Laurent Massinon
Partner
Luther Avocats à la Cour
Luxembourg
Phone +352 27484 658
laurent.massinon@luther-lawfirm.com

Darius Bitu
Associate
Luther Avocats à la Cour
Luxembourg
Phone +352 27484 689
darius.bitu@luther-lawfirm.com

Revision of collateral rules in ESMA's guidelines on ETFs and other UCITS issues

Review process

Following the entry into force of the Guidelines on ETFs and other UCITS issues (ESMA/2012/832) (the "**Guidelines**") in February 2013, the European Securities and Markets Authority ("**ESMA**") has been asked in many instances to review its requirements on collateral diversification (as detailed under paragraph 43(e) of the Guidelines) given their adverse impact on UCITS collateral management policies[1].

In December 2013, ESMA published a consultation paper seeking to address stakeholders' concerns by proposing several amendments to paragraph 43(e) of the Guidelines on the diversification of collateral received by Undertakings for Collective Investment in Transferable Securities ("**UCITS**") in the context of efficient portfolio management ("**EPM**") techniques and over-the-counter ("**OTC**") financial derivatives transactions. On 24 March 2014, ESMA issued its Final report containing revised collateral diversification rules (ESMA/2014/294) (the "**New Guidelines**") which shall apply two months after publication of the New Guidelines' translations on ESMA's website (the "**Application Date**").[2]

New provisions

The New Guidelines create a more flexible framework for the use of EPM techniques and OTC transactions by introducing the following derogation from the existing requirements on collateral management (i.e. maximum exposure to a single issuer of 20% of a UCITS' net asset value) for all types of UCITS funds:

---

1 In Luxembourg, the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") implemented the Guidelines through Circular CSSF 13/559

2 As at 05 May 2014 no translation of the New Guidelines had been published on ESMA's website. Readers should therefore check ESMA's website for such publication. For the avoidance of doubt, we shall keep you updated as regards the Application Date.

- By way of derogation, a UCITS may be fully collateralised in transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong;

- In terms of diversification, such a UCITS should receive securities from at least six different sovereign issues, provided however that securities from any single issue should not account for more than 30% of the UCITS' net asset value;

- Furthermore, a UCITS intending to use this derogation should disclose this fact in its prospectus, and include specific information in its annual report (i.e. where collateral received from an issuer has exceeded 20% of the net asset value of the UCITS, the identity of that issuer; and details as to whether the UCITS has been fully collateralised in securities issued or guaranteed by a Member State).

Transitional period

Lastly, it should be noted that the prospectus and accounts disclosure requirements are subject to the following transitional provisions:

- UCITS which exist before the Application Date are not required to comply with the rules relating to prospectus transparency on collateral diversification until the earlier of: (i) the first occasion after the Application Date on which their prospectus (having been revised or replaced for another purpose) is published, and (ii) twelve months after the Application Date;

- Requirements to publish the relevant information in the report and account of an existing UCITS do not apply in respect of any accounting period that has ended before the Application Date.

CSSF and ESMA / AIFMD related developments

CSSF FAQs in relation to AIFMD

During the first quarter of 2014, the CSSF published three updates of its Frequently Asked Questions (the "**FAQs**") concerning the Luxembourg law of 12 July 2013 on alternative investment fund managers (the "**AIFM Law**") as well as the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage transparency and supervision.

The updates were published as follows:

- Fourth update dated 10 January 2014,

- Fifth update dated 20 February 2014, and

- Sixth update dated 17 March 2014.

The fourth version of the FAQs:

Introduces *inter alia* answers concerning marketing issues and reporting related aspects. It also updates existing sections such as those relating to the scope, the entry into force of the AIFM Law and the transitional provisions applicable to Luxembourg alternative investment fund managers ("**AIFMs**") and Luxembourg alternative investment funds ("**AIFs**").

The updated FAQs thus encompassed the following additional/updated information in their fourth version:

<table>
<tr><th colspan="2">NEW SECTIONS</th><th colspan="3">UPDATES OF EXISTING SECTIONS</th></tr>
<tr><th>Marketing issues
(Chapter II. Sections 11 through 13)</th><th>Reporting related aspects
(Chapter II. Section 14)</th><th>Scope
(Chapter II. Section 1)</th><th>Entry into force of the AIFM Law and the transitional provisions
(Chapter II. Section 8)</th><th>List of cooperation agreements
(Chapter II. Section 15)</th></tr>
<tr><td>Clarifications concerning inter alia:
▪ provisions applicable to Luxembourg authorised AIFMs intending to market EU AIFs in the EU and scenarios available for AIFMs established in Luxembourg marketing EU AIFs in the EU under the AIFMD marketing passport (Section 11);
▪ marketing in Luxembourg of EU AIFs by AIFMs established in another EU Member State. Confirmation that existing Luxembourg placement rules will continue to be permitted until 22 July 2014 regarding the marketing of AIFs in Luxembourg by AIFMs (Section 12);
▪ notification file content as regards marketing of non-Luxembourg EU AIFs to professional investors in Luxembourg and in another EU Member State (Section 13).</td><td>Clarification concerning the CSSF approach on reporting obligations (inter alia reporting periods, first reporting period). The CSSF further provides tables and practical examples concerning the reporting periods.
Indication, inter alia, as to applicability of reporting obligations to:
▪ AIFMs benefitting from the transitional provisions set out in the AIFM Law;
▪ non-EU AIFM which manages a Luxembourg AIF independently of where the Luxembourg AIF is marketed.
Reporting aspects mentioned in the FAQs should be read in conjunction with ESMA's guidelines on reporting obligations under Articles3(3) (d) and 24(1), (2) and (4) of the AIFMD (ESMA/2013/1339) (the "ESMA Reporting Guidelines")</td><td>Insertion of clarifications concerning AIFs structured as FCP as or limited partnership (internal vs. external AIFM):
▪ determination of the AIFM: Chapter II. 1.e) (new)
▪ indication concerning the entity in whose name the registration shall be made: Chapter 1.f) (new)</td><td>Update of the existing FAQs.</td><td>Extension of MoU network between CSSF and authorities of New Zealand (Financial Markets Authority) and South Africa (Financial Services Board)</td></tr>
</table>

The fifth version of the FAQs:

Provides for clarifications concerning:

- valuation of the AIF's assets and concerning the following items (question 15):
  - types of valuation set-ups foreseen by the AIFM Law;
  - who may be appointed as external valuer;
  - how to formalise the external valuer's appointment; and
  - whether the administrator may be appointed as external valuer.
- disclosure of transaction costs in the periodical financial reports of UCIs (i.e. AIFs established under Part II of the law of 17 December 2010 relating to undertakings for collective investment, as amended) (question 16).

The Sixth version of the FAQs:

Provides clarification with regards to the start date of the initial reporting period for authorised and registered AIFMs and the date as of which authorised and registered AIFMs authorised or registered before 23 July 2014 have to file their first reports with the CSSF (new section 14.d) inserted and old section 14.d) became 14.e) and was slightly amended. Further numbering amended accordingly);

The latest version of the FAQs is available on the CSSF's website.

Older versions of the FAQs many also be found on the CSSF's website.

CSSF Circular 14/581 relating to Reporting obligations for AIFMs

The CSSF published Circular 14/581 dated 13 January 2014 Re: New reporting obligations for Alternative Investment Fund Managers, addressed to all Alternative Investment Fund Managers governed by Luxembourg law and to those involved in the operation and control of these entities.

The aim of the circular is to clarify the technical details to enable AIFMs to comply with their reporting obligations. It comprises appendices detailing the files to be transmitted (content for AIFM and for AIF reporting). Concerning operational aspects, the CSSF refers to the FAQs and the ESMA Reporting Guidelines.

This circular also sets out the submission channels to be used with regards to the reportings.

The circular is available on the CSSF's website:

ESMA Q&As relating to AIFMD

ESMA published Q&As dated 17 February 2014 with regards to the application of AIFMD on its website. These Q&As were updated on 25 March 2014.

The Q&As cover questions relating *inter alia* to:

- the first application of remuneration rules;
- remuneration rules in case of delegation of portfolio or risk management activities;
- Annex IV of the AIFMD (Documentation and information to be provided in the case of intended marketing in Member States other than the home Member State of the AIFM);
- notifications of AIFs;
- reporting requirements under Article 42 of the AIFMD (Conditions for the marketing in Member States without a passport of AIFs managed by non-EU AIFM);
- clarifications concerning technical reporting and notably but not exclusively (i) whether repurchase transactions are to be considered as financing operations, (ii) items related to the computation of geographical exposure, (iii) computation of market value for certain assets, (iv) timing of submission of last report in case of liquidation of a given AIF, (v) reporting on investor liquidity, (vi) meaning of the term "inception date" of a given AIF, (vii) language of reporting and (viii) the consolidated reporting template.

The purpose of these Q&As, as stated by ESMA, is "to promote common supervisory approaches and practices in the application of the AIFMD and its implementing measures". Their aim is twofold: (i) ensuring convergence supervisory activities of competent authorities in line with ESMA responses and (ii) helping AIFMS by "providing clarity as to the content of the AIFMD rules".

The Q&As are available on the ESMA´s website.

For additional information and details, please contact:

Jeannette Vaude-Perrin
Counsel
Luther Avocats à la Cour
Luxembourg
Phone +352 27 484 692
jeannette.vaude-perrin@luther-lawfirm.com

Julie Thai
Senior Associate
Luther Avocats à la Cour
Luxembourg
Phone +352 27484 667
julie.thai@luther-lawfirm.com

Imprint
Luther Rechtsanwaltsgesellschaft mbH, Anna-Schneider-Steig 22,
50678 Cologne, Phone +49 221 9937 0, Fax +49 221 9937 110,
contact@luther-lawfirm.com
Editor: Eric Sublon, Luther, Aerogolf Center, 1B, Heienhaff,
L-1736 Senningerberg, Phone +352 27484 1, Fax +352 27484 690,
eric.sublon@luther-lawfirm.com

Luther advises in all areas of business law. Our clients include medium-sized companies and large corporations, as well as the public sector.

Berlin, Cologne, Dresden, Dusseldorf, Essen, Frankfurt a. M., Hamburg, Hanover, Leipzig, Munich, Stuttgart
Brussels, Budapest, London, Luxembourg, Shanghai, Singapore

Further contacts can be found on our website www.luther-lawfirm.lu

Hits the mark. Luther.