ELVINGER, HOSS & PRUSSEN
AVOCATS A LA COUR

MEMORANDUM

AMENDMENTS TO THE LAW OF 1915 ON COMMERCIAL COMPANIES BY THE TWO LAWS OF 23RD MARCH 2007

This memorandum is a summary of the legal topics discussed herein and does not constitute legal advice.

The law of 10th August 1915 on commercial companies (the "Law") has been amended by two laws dated 23rd March 2007, respectively implementing bill of law n° 4992 (hereafter referred to as the first law of 23rd March 2007) and bill of law n° 5658 (hereafter referred to as the second law of 23rd March 2007).

The amendments consist in

- the introduction of the possibility of legal mergers and divisions involving companies of any legal form and economic interest groupings;
- the introduction of provisions concerning cross border mergers and divisions;
- the introduction of provisions governing transfers of assets, branch of activity transfers and all assets and liabilities transfers;
- the introduction of regulations concerning transfers of professional assets;
- the removal of certain restrictions on the payment of interim dividends in *sociétés anonymes* and *sociétés en commandite par actions* and
- the correction of a number of drafting errors.

1) *Mergers and divisions involving companies of any legal form and economic interest groupings*

Prior to the enactment of the first law of 23rd March 2007, the provisions of the Law concerning mergers and divisions were limited in their application to *sociétés anonymes* (SAs).

Even *sociétés en commandite par actions* (corporate partnerships limited by shares or SCAs) which are subject to the provisions of the Law regarding *sociétés anonymes* except for those matters dealt with in the specific section of the Law governing SCAs, were excluded from the rules on mergers and divisions.

The fact that the Law did not provide for legal mergers or divisions involving SCAs, *sociétés à responsabilité limitée* (private limited companies or Sàrls) or other forms of companies had a number of disadvantages. Whilst transactions could be structured so as to obtain certain of the results achieved by a legal merger or division (and whilst tax law provided, subject to certain conditions, for a tax neutrality of mergers or divisions of SAs, SCAs and Sàrls), there was no mandatory universal transfer of all assets and liabilities normally associated with a legal merger or division. This proved particularly problematic concerning Sàrls as this form of company had in the last few years, for a number of reasons, proven extremely popular for private equity transactions structured out of Luxembourg.

Pursuant to the amended articles 257 and 285 of the Law, legal mergers (*fusions*) and divisions (*scissions*) may now involve all types of commercial companies which have legal personality, civil (i.e. non commercial) companies (*sociétés* civiles) and economic interest groupings.

Mergers and divisions may not only occur between companies of the same legal form or between economic interest groupings, but may also involve various companies of different legal forms and / or economic interest groupings.

The rules on mergers and divisions now also apply to companies or economic interest groupings which are the subject of bankruptcy or other insolvency or liquidation proceedings. Under the previous legislation, companies in such a situation could not take part in mergers and divisions.

Companies having shareholders with unlimited joint or several liability (such as the *société en nom collectif* (unlimited company), the *société en commandite simple* (limited corporate partnership), the *société en commandite par actions* (corporate partnership limited by shares) and the *société civile* (civil company)) may now be involved in mergers or divisions. In order to deal with issues arising out of that situation, the first law of 23rd March 2007 contains specific consent requirements and rules governing the liability of those shareholders:

- If the acquiring company (*société absorbée*) (in case of a merger) or one of the recipient companies (*sociétés bénéficiaires*) (in case of a division) is a company where all or some members have unlimited joint or several liability or is an economic interest grouping, the members or shareholders of the company or grouping being acquired or being divided will, as a result of the merger, also become jointly or severally liable for the obligations of the acquiring or recipient company or grouping.

  In addition, the members with unlimited joint or several liability of the acquiring or recipient company will as a result of the merger or the division become liable for the debts of the company being acquired or for the debts of the divided company which are transferred to the recipient company.

  The Law provides that the consent of all members whose joint and several liability will thus be affected will therefore be required for the merger or division to proceed.

- As regards the liability for pre-merger or pre-division liabilities, if the company being acquired (*société absorbée*) or being divided (*société scindée*) is a company with shareholders who have unlimited liability, these shareholders will remain liable (jointly or severally, as applicable) vis-à-vis third parties for the obligations of the company being acquired or being divided which pre-date the effectiveness against third parties of the merger or division.

  Conversely, if the acquiring company (*société absorbante ou bénéficiaire*) is a company with shareholders who have an unlimited joint or several liability, the principle under the Law is that these shareholders will, vis-à-vis third parties, be liable for the obligations of the company being acquired or being divided which pre-date the effectiveness of the merger vis-à-vis third parties.

  The same rule applies in case of a division, where the recipient company has shareholders with unlimited liability, but the extent of the liability will be limited to the pre-division obligations of the company being divided that are transferred to the recipient company under the draft terms of division (plus any obligations not clearly allocated by the draft terms of mergers to a specific recipient company).

  However, in a merger, the shareholders with unlimited joint and several liability in an acquiring company may be relieved of the liability for the pre-merger obligation described above liability if this is expressly provided for in the draft terms of the merger and in the merger deed.

The first law of 23rd March 2007 did not introduce any other substantial change to any of the provisions of the Law regarding mergers or divisions except those discussed below, certain specific provisions applicable to *sociétés coopératives* and pure consequential changes.

2) Cross-border mergers and divisions

Even though in the past, the Law specifically regulated only national mergers of *sociétés anonymes*, there have been a number of cross border mergers involving Luxembourg companies. In these transactions there was generally a cumulative application of the requirements of the Law to the Luxembourg company involved and of the requirements of the relevant foreign legislation to the foreign company involved.

The untested element in these transactions was whether these mergers would benefit from the effectiveness between the companies involved and vis-à-vis third parties of the universal transfer of all of the assets and liabilities of the company being acquired to the acquiring company.

The Law now provides that a merger or division can occur between a Luxembourg and a foreign company or economic interest grouping provided the latter's national law does not prohibit such a transaction (contrary to corporate law, tax law already contained provision dealing with cross border mergers or divisions). It also provides for the effectiveness of the universal transfer of assets and liabilities. The Law therefore pre-empts directive 2005/56/EC on cross-border mergers (the "Directive") whose implementation is due by 15th December, 2007. Neither of the two laws of 23rd March 2007 was designed as an implementation law for the Directive.

The main provisions regarding cross-border mergers and divisions were introduced by the first law of 23rd March 2007. The second law of 23rd March 2007 only deals with certain procedural aspects of a cross-border merger, derogates from the general rule regarding the point in time from which a merger is effective and introduces a specific bar to the avoidance of a cross-border merger.

The legislator basically followed what corporate practice had applied previously and what the Directive requires. For the Luxembourg company or economic interest grouping involved in a cross-border merger or division, the rules provided for by the Law will have to be complied with. The foreign entity involved in the transaction will have to comply with the rules of its jurisdiction.

The second law of 23rd March 2007 in addition requires that the fulfilment of all conditions is confirmed by a formal deed. In Luxembourg this is done through a certificate from a notary. This procedural step is inspired by article 11 of the Directive.

If the acquiring company is a Luxembourg company, the Luxembourg notary will need to obtain the appropriate confirmations from a notary or other competent authority in the foreign jurisdiction (a pre-merger certificate) before he can issue his own certificate. This is consistent with what article 10 of the Directive provides.

The second law of 23rd March 2007 also provides for a derogation to the general rule concerning the date as from which a cross-border merger is effective vis-à-vis the shareholders and vis-à-vis third parties. A national merger takes effect amongst the shareholders upon the adoption of concurrent decisions of the companies involved. A national merger is effective vis-à-vis third parties after publication of the merger deed in the legal gazette, the Mémorial C.

In case of a cross-border merger, the rule is different as the merger will take effect amongst the parties and be effective vis-à-vis third parties after publication in the Mémorial C of the minutes of the general meeting of the acquiring company resolving on the merger, subject to the notary having confirmed that all procedures have been completed (which obviously include the approval of the merger by the shareholders' meetings of all the entities involved). This is consistent with article 12 of the Directive.

The second law of 23rd March 2007 derogates from the rules governing the avoidance of a merger. It specifically provides that once a merger by way of acquisition of a foreign company has become effective in accordance with the rules summarised above, the avoidance of the merger can no longer be ordered. This is precisely what article 17 of the Directive provides.

3) Transfers of assets, branch of activity transfers and all assets and liabilities transfers

Companies wishing to sell or contribute, and the proposed acquirors wishing to buy, a branch, a separate business or division or a part of the activities of the seller without proceeding to a legal division, were confronted with the difficulty that absent a legal division (*scission*) of the seller or transferor, there was no automatic transfer of assets and liabilities. This made the sale and acquisition of a separate business or division more complex and in certain cases unattractive.

The Law now allows a company contributing part of its assets to another company and the receiving company to jointly determine to submit such transaction to the rules governing divisions. The advantage of exercising such "opt in" option is that, by operation of law, the contribution will result in the transfer to the receiving company of such assets and of the liabilities attaching thereto. Loan financed assets could for instance be transferred with the loan obligation attached (without prejudice to contractual covenants to the contrary).

The same "opt-in" right exists for the contribution of one or more branches of activities and for all assets and liabilities contributions, in each case, against the issue of shares. On exercise of the "opt-in" right, these transactions will also be subject to, and have the benefit of, the rules on divisions including in particular the universal transfer of all assets and liabilities of the relevant branch of activity of the contributing entity.

As the application of such rules is an option for the parties, it is still possible to make "simplified" all assets and liabilities contributions without applying the rules on divisions.

The Law defines "branch of activity" as a division which from a technical and organisational point of view exercises an independent activity and is capable of functioning by its own means.

In addition to a contribution against the issue of shares, a substantial novelty is that the Law also allows the parties involved the right to opt for the application of the rules governing divisions in case of a sale of assets, of a branch of activity or of all assets and liabilities for a consideration other than shares i.e. for cash or in case of an assignment without consideration. In case of exercise of such "opt-in", the Law provides for an universal transfer to the beneficiary company of all assets that are being transferred with the liabilities attaching thereto.

A transfer of assets or of a branch of activity can therefore be structured from the corporate point of view either as a two-step transaction consisting first in the contribution to the acquiror of the assets or the branch of activity against the issue of shares in the acquiror to the contributing company, followed by a sale of those shares to a parent or affiliate of the receiving company, or as a one-step transaction where the transaction is structured as an outright sale against consideration in cash, and where the parties elect to exercise the opt-in right.

4) Transfer of professional assets

The newly introduced provisions regarding transfers of professional assets apply to the transfer of all or part of the professional assets of a legal entity or a natural person. These transfers may occur nationally but also cross-border with a foreign company, a foreign economic interest grouping or a foreign natural person, provided the latter's national law does not prohibit such transaction.

The Law does not define the concept of professional assets. Insofar as SAs, S.àr.l.s or SCAs (i.e. corporations) are concerned, all their assets are deemed professional assets. Insofar as natural persons are concerned, the discussions during the bill of law referred to the concept prevailing in Luxembourg tax law of "net invested assets" (*actif net investi*). In summary, professional assets of a natural person will comprise those assets which are necessary or are used by a natural person to exercise his or her profession or business activity. In case of a natural person exploiting a commercial business, it will comprise those assets which are part of the business. It must be noted that tax law will allocate certain assets of the natural person to the *actif net investi* even if they are not allocated by the person.

As *sociétés en nom collectif*, *sociétés en commandite simple* and *sociétés civiles* are transparent for tax purposes, the principles allowing identification of professional assets of natural persons should also apply, with certain adjustments if one or more members of such companies are a corporation. However for the purpose of a transfer of professional assets, those assets allocated to a *société en nom collectif, société en commandite simple* and *société civile* by tax law but which do not feature on the balance sheet of such entities, should be able to be excluded from the professional assets of such entity.

The provisions regarding divisions will apply where the transferring and receiving persons are companies or economic interest groupings and where the shareholders of the transferring company or grouping receive shares in the receiving company or grouping.

Specific rules set out in Section XVter of the Law will apply in all other circumstances.

These rules are loosely based on certain principles governing a division such as the requirement to draw up draft terms of transfer which need to contain an inventory of the assets and liabilities to be transferred, the publication of such draft terms and the need to draw up a written report on the draft terms of transfer.

A transfer of professional assets may only happen under the Law if the inventory shows an excess of assets. In order to determine whether this is the case, the draft terms need to contain an indication of the total value of the assets and liabilities to be transferred.

The transfer of professional assets governed by the Law results in the transfer to the receiving entity or person of all the assets and liabilities specified in the inventory. As a safeguard for creditors of the transferor, the Law provides that the transferring entity or person shall remain jointly and severally liable during three years with the receiving entity or person for the satisfaction of those debts which pre-date the transfer.

The rules on avoidance of a transfer of preferential assets are largely similar to those governing the avoidance of divisions.

5) Removal of certain restrictions on payment of interim dividends

When the legislator introduced the possibility for the board of directors of a *société anonyme* to pay interim dividends, it followed a suggestion by the Council of State and inserted certain limitations as to the frequency of such payments, or more accurately as to the period after which, and the frequency in which, the board could take such decisions. These limitations essentially resulted in the situation that a board of directors could not, during any financial year, take more than two or possibly three decisions to pay interim dividends.

In particular there could be no decision to pay an interim dividend before six months had elapsed after the close of the previous fiscal year. After a first decision to pay an interim dividend had been taken, a second decision could not be taken for another three months.

Compared to other jurisdictions, this sometimes proved to be a serious restriction which, as experience showed, was not really addressing any particular need to protect creditors. Indeed the directors can only resolve to pay an interim dividend if an accounting statement shows that there are sufficient distributable reserves and if the auditors have confirmed that all conditions are fulfilled.

These timing restrictions have now been removed.

Subject to the availability of distributable reserves, the establishment of an accounting statement evidencing the existence of such reserves and a confirmation by the auditors, a decision to pay interim dividends can now be taken by the board of directors or management board of a *société* anonyme, or the manager of a SCA at any time during the fiscal year and there is no limit as to the frequency of such decisions.

6) Corrections of drafting errors

The law of 1915 contained a number of small errors and inconsistencies, some resulting from the inadvertent reintroduction of recently abrogated provisions by the law of 25th August 2006. Most of these errors had been highlighted in the previous editions of our English translation of the Law published by the Service Central de Législation in 2003 and more recently in the updated version of the translation published on our website. None of these corrections result in a material change to the Law. The only noteworthy correction is that the law of 10th July 2005 on the prospectus for securities had abrogated the requirements to insert certain particulars on physical bearer bonds. The law of 25th April 2006 had inadvertently reintroduced those requirements which have now again been removed.

Luxembourg, 12th April 2007