FINANCING IN PE


©DR

By **Delphine Gomes,**
Counsel at AKD

Constantin Iscru,
Counsel at DLA Piper

Azadeh Djazayeri,
Partner at Elvinger Hoss Prussen

And **Ana Bramao,**
Partner at Elvinger Hoss Prussen

New Luxembourg Reorganisation Law and Financial Collateral Arrangements

This publication was drafted by the LPEA committee "Financings in Private Equity of the LPEA"

The Luxembourg insolvency law toolkit has been recently revamped by a new law of 7 August 2023 which has entered into force on 1st November 2023 (the "**Reorganisation Law**") and has repealed certain obsolete insolvency procedures being: (i) controlled management (gestion contrôlée), and (ii) composition with creditors (concordat préventif de la faillite) and has introduced new procedures aiming at detecting at early stages companies in financial difficulty to avoid bankruptcy and preserve their business.

The Reorganisation Law also implements EU Directive 2019/1023 of the European Parliament and of the Council of 20 June 2019 on, inter alia, preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (the "**Insolvency Directive**") for which one of the main goals was to harmonize the insolvency procedures between Members States.

The Reorganisation Law does not impact the enforcement of financial collateral arrangements (taking the form of a pledge, a transfer of title by way of security, a repurchase agreement or a fiduciary transfer arrangement) falling within the scope of the Luxembourg law of 5 August 2005 on financial collateral arrangements, as amended (the "**Financial Collateral Law**").

This principle is confirmed both by the Insolvency Directive and the parliamentary works relating to the Reorganisation Law:
(i) Whereas (94) of the Insolvency Directive provides that "The stability of financial markets relies heavily on financial collateral arrangements […]. As the value of financial instruments given as collateral security may be very volatile, it is crucial to realise their value quickly before it goes down." In addition, it provides that the provisions of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements should apply notwithstanding the provisions of the Insolvency Directive.
(ii) The preparatory works (doc. parl.6539 and 6539A), provide, in turn, that the Financial Collateral Law shall not be impacted by the Reorganisation Law. The Luxembourg Council of State issued an advice on 1 December 2015 whereby it declared « the bill of law shall not impact the financial collateral arrangements falling within the scope of the law of 5 August 2005 on financial collateral arrangements » doc.parl.6539-7, p.2) and on 14 June 2023 that « beneficiaries of a financial collateral arrangement – taking for example a pledge agreement over receivables or financial instruments – shall not be affected by reorganisation proceedings and should therefore have the right to enforce their pledge during the suspension period» and again that « the impact of the 2005 law on preventive measures aiming at safeguarding enterprises shall not be disregarded" (doc.parl.6539A-5, p.12-13).

The Reorganisation Law introduced a new procedure of judicial reorganisation (réorganisation judiciaire) that could however have an impact (although marginal) on pledge agreements covered by the Financial Collateral Law.
Indeed, pursuant to article 30 of the Reorganisation Law, after the filing of a judicial reorganisation application and while a judicial reorganisation measure is ongoing, it is not permitted for a creditor to (i) accelerate the underlying debt or (ii) terminate the underlying agreements. This prohibition stems from article 7 paragraph 5 of the Insolvency Directive which provides that "Member States shall ensure that creditors are not allowed to withhold performance or terminate, accelerate or, in any other way, modify executory contracts to the detriment of the debtor […]" in case of a reorganization proceeding.

What does this mean in practice?

The key takeaway is that it is not prohibited to enforce a pledge subject to the Financial Collateral Law as long as the enforcement is not conditional exclusively upon the acceleration of the underlying debt owed by a Luxembourg borrower subject to a judicial reorganization proceeding.

The pledgee can enforce the pledge on the basis of other enforcement events, such as a cross-default, a breach of financial covenant or any "event whatsoever as agreed between parties as constituting an enforcement event". The addition of the word "whatsoever" to the definition of enforcement event under the Financial Collateral Law has been introduced by the law of 20 July 2022 to emphasise that the parties are entirely free to determine by agreement the events the occurrence of which may trigger the enforcement of the collateral without the financial obligations having to become necessarily due and payable. The parliamentary work on the Law of 20 July 2002 cites examples such as non-compliance with certain financial ratios (which had been confirmed by the Courtepaille judgment) or other factors relating to particular aspects of a transaction.

The Law of 20 July 2022 has also introduced a new provision in the Financial Collateral Law pursuant to which where the relevant financial obligations are not due at the time the collateral arrangement is enforced, the proceeds of the enforcement shall be, unless otherwise agreed, applied to satisfy the relevant financial obligations. This new paragraph is directly related to the definition of "enforcement event", which allows the pledgee to enforce its collateral arrangement following a default or any other event whatsoever as agreed between the parties while the secured obligations are not necessarily due and payable.

Lawyers from major Luxembourg law firms have recently joined the LPEA "Financings in PE" committee to discuss the practical implications of article 30 of the Reorganisation Law. They came to the conclusion that the new Reorganisation Law would have a very limited impact for existing agreements because, in their experience, finance documents usually provide for flexible enforcement triggers which do not entirely depend on the acceleration of the underlying debt owed by Luxembourg borrowers. With respect to future pledge agreements, it will be a question of carefully drafting the relevant pledge agreement and having regard to the conditions of enforcement under the main financing documentation as well. ●

"Lawyers from major Luxembourg law firms came to the conclusion that the new Reorganisation Law would have a very limited impact for existing agreements."