The Place of the PPG (*Garantie Professionnelle de Paiement*) in the Luxembourg Legal System

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"*Change can be frightening, and the temptation is often to resist it. But change almost always provides opportunities – to learn new things, to rethink tired processes, and to improve the way we work*."

Klaus Schwab

Introduction

1. On 10 July 2020, the Luxembourg Parliament (Chambre des Députés) adopted a new law relating to professional payment guarantees (*garanties professionnelles de paiement*, hereafter "PPG") which came into force on 17 July 2020 (hereafter "PPG Law").

2. Similar to the law of 5 August 2005 on financial collateral arrangements, as amended (the "Collateral Law"), a contractually flexible and yet protective legal regime for security arrangements of paramount importance in the context of international financial transactions, this new law introduces a special regime for personal guarantees, which are equally important in the context of such international financial transactions but not only, as an alternative to the traditional regimes of personal guarantees existing under Luxembourg law: the suretyship (*cautionnement*) and the first demand guarantee (*garantie à première demande*).[1]

3. It is generally admitted that the existing Luxembourg law regimes of the autonomous guarantee and suretyship do not always satisfy the structuring

[1] Bill of law relating to the professional payment guarantees, *Doc. parl.* No. 7567/00.

needs of certain financiers or other users of personal guarantees, especially where the guarantee purports to combine certain characteristics of both the suretyship and the autonomous guarantee resulting in a risk of requalification into a suretyship, who often resort to foreign law governed guarantees which allow for greater contractual freedom in their structuring. These structuring difficulties arise in the private and public sector alike such as in the context of operations promoted by the European Commission within the framework of the capital markets or by States and aimed at providing financial support to certain economic segments and which benefit, e.g. from State guarantees, guarantees from the European Investment Bank or European Investment Fund. Although unrelated to the adoption of the new law on professional guarantees, the COVID-19 crisis and the economic relief initiatives undertaken at European and national level constitute already a contemporaneous example of a situation in which the new regime on professional guarantees will prove to be particularly useful.[2]

4. The PPG will no doubt enhance the competitiveness of Luxembourg law governed collateral and guarantee arrangements in that it removes the risk inherent to the autonomous guarantee of being requalified into a suretyship and which is common to many civil law systems as opposed to guarantees governed by the laws of an Anglo-Saxon jurisdiction. Will the PPG however partially or fully eclipse the suretyship and the autonomous guarantee in the future?

5. It is certainly not the intention of the authors of the bill of law[3] but this type of guarantee is said to have the potential to replace the suretyship and autonomous guarantee in the Luxembourg legal field. Practitioners seem to agree on this point, one of them claiming even that "it is not unrealistic to consider that the introduction of the PPG may make disappear – in practice – all the other personal guarantees."[4]

6. The above statement will be tested against the main legal features of the PPG (I) and in relation to selected financing, commercial, construction and unfunded credit protection operations (II), it being noted however that we do not pretend nor intend to be exhaustive of all the instances or practice areas in which the PPG may be relevant.

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2 A. Canto, P. Dorin and S. Jacoby, "La nouvelle loi sur les garanties professionnelles de paiement: une garantie personnelle sous le signe de la liberté contractuelle" (2020) 66 *Bulletin Droit et Banque*, ALJB 7–15.

3 *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 6.

4 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, Tome 3: les sûretés personnelles (Bruxelles, Larcier, 2021) 710. We are translating.

Chapter I. The Legal Regime of the PPG

7. A PPG is an undertaking by which the guarantor undertakes to pay a beneficiary, on demand of such beneficiary or an agreed third party, an amount determined pursuant to agreed terms, in relation to one or more claims or associated risks.[5]

8. The ingenuity of the PPG regime lies foremost in its simplicity and flexibility: (i) limited form and substance conditions apply; and (ii) its regime is inspired by contractual freedom. The PPG is said to bridge the *summa divisio*[6] of the traditional regimes of the suretyship and the first demand guarantees by taking the best of both worlds.

Section 1. Light Formalism

9. The granting of a PPG merely requires the written form[7] and, since it is an opt-in regime, it must contain an express indication that the guarantee is subject to the PPG Law.

§ 1. The Necessity to Attest the Guarantee in Writing

10. The commentators of the bill of law acknowledged that, in most cases, PPGs are likely to consist in commercial acts subject to Article 109 of the Luxembourg Commercial Code[8] pursuant to which commercial deeds may be evidenced freely between parties.

11. However, the requirement of the written form is consistent with the nature of the PPG in that it is designed as a contract-based instrument the terms of which ought to be documented in writing – such contractual terms are protected against the effects of other guarantee regimes by virtue of a specific reference in the guarantee arrangement that it is subject to the PPG Law and to afford greater legal certainty to the contracting parties (similar to collateral arrangements under the Collateral Law).[9]

§ 2. A Guarantee by Choice

12. PPGs are reserved for contracting parties (or the guarantor if it issues a unilateral deed) that explicitly and unequivocally state[10] that they wish their guarantee to be governed by the PPG Law.

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5 Art. 2 of the law relating to professional payment guarantees.
6 A. Canto, P. Dorin and S. Jacoby, "La nouvelle loi…", *op. cit.*, 8.
7 Art. 3 of the PPG Law provides that "evidence of writing may be brought in electronic or any durable form".
8 *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 6.
9 Art. 2 of the Collateral Law.
10 No sacramental wording is imposed.

13. Indeed, the legislator did not intend to impose the regime of the PPG Law as a triumphant guarantee regime exclusive of other types of guarantee available under Luxembourg law but rather to complement the offer with a new type of guarantee.

14. The requirement to indicate a reference to the PPG Law is a simple and yet effective means to protect the PPG against the risk of requalification which may exist for other forms of guarantee arrangements.

Section 2. Contractual Freedom in Terms of Scope of Obligations

15. The letter and structure of the PPG Law are revealing of the legislator's intention to address the shortcomings of the traditional forms of guarantees available under Luxembourg law. In doing so, the legislator (i) relied on contractual freedom while providing for fallback solutions where the agreement is silent; and (ii) clarified certain features and effects of the guarantee (in particular those that usually raise concerns when they relate to the traditional forms of guarantee), more specifically to ensure greater legal certainty.

16. Illustrations of the contractual freedom can be found in Articles 2 and 4 of the PPG Law which provide for freedom in terms of:

17. *Guaranteed obligations.* A PPG may be entered into in connection with all types of claims and associated risks thereof without restriction in relation to their nature or their object.[11] Hence, a guarantor may undertake to pay a sum of money under a PPG to guarantee obligations to give (*obligations de donner*), obligations to do (*obligations de faire*) and obligations not to do (*obligations de ne pas faire*), to guarantee existing claims, future claims or even hypothetical claims as well as pecuniary or non-pecuniary obligations, to deliver financial instruments or any other asset, to guarantee individual claims or risks or portfolios of claims and associated risks, in the latter case, no matter if the composition of the portfolio is stable or changes during the course of the agreement provided only that the sum payable under the PPG is determined or determinable and subject to compliance with mandatory rules and rules of public order.[12]

18. Notwithstanding the large scope of obligations that it is possible to guarantee, there should be no concerns in terms of cause of the guarantee (i.e. the consideration of the obligation, the reason for undertaking an obligation). Indeed, in connection with autonomous guarantees, it is considered that the cause of the agreement exists when the principal (*donneur d'ordre*) has an economic interest in the conclusion of the underlying arrangement, even if it is not a party to the underlying agreement.[13] French courts consi-

11 *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 5.

12 *Ibid.*, 5–6.

13 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 715.

der that it is not necessary for the underlying agreement to exist, it suffices for the principal to have an economic interest in the conclusion of such agreement. "Undertaking an obligation without any specific goal could only be the doing of a mad person."[14] The same rationale should be applied to PPGs.[15] The PPG finds its cause in the existence of a claim or a risk associated thereof to guarantee.

19. *Guaranteed Amount*. As opposed to an autonomous guarantee in relation to which references to the underlying guaranteed obligation in order to determine the guaranteed amount can prejudice its autonomous nature, the PPG Law allows the parties to contractually determine the amount payable under the PPG and, in so doing, "[t]he parties may expressly refer to the claims or the associated guaranteed risks for the determination of the amount, the terms and the duration of the guarantee".[16]

20. *Enforcement*. All the aspects of the enforcement can be contractually adjusted, starting with who can call the guarantee, the beneficiary or a designated third party, the circumstances in which the guarantee may be called, even in the absence of a default under the underlying guaranteed obligation, the conditions that need to be fulfilled for a valid call of the guarantee, e.g. with or without notice of enforcement.

21. While it is inconceivable to accommodate that much contractual freedom with a suretyship due to the accessory nature of the suretyship, achieving the same contractual freedom with an autonomous guarantee is possible but remains challenging without jeopardising its autonomous nature. The PPG proves once more to be most flexible.

22. *Exceptions to enforcement*. The legislator left it to the parties to contractually determine whether or not any exceptions pertaining to the claims or risks in relation with which the guarantee was concluded may be invoked to challenge payment under the guarantee. In the absence of contractual provisions dealing with exceptions, the legislator adopted the principle that no exceptions may be invoked as is the case with autonomous guarantees but not suretyships.

23. The commentators of the bill of law however objected to this principle in the case of abuse (*abus*), manifest fraud (*fraude manifeste*) of the beneficiary and fraudulent collusion (*collusion frauduleuse*) between the principal and the beneficiary[17] based on the Latin idiom *fraus omnia corrumpit*. There is very limited Luxembourg case law on this topic in the context of guarantees due to the fact that judges are reluctant to challenge the efficiency of independent guarantees. It is generally considered that an abuse of rights does not require

[14] H. Capitant, *De la Cause des obligations* (Paris, Dalloz, 1923) No. 7, we are translating.
[15] *Ibid*.
[16] Art. 4(2) of the PPG Law.
[17] *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 8.

a malicious intent; it is sufficient for a person to use a right beyond its boundaries. On the contrary, manifest fraud requires its perpetrator to voluntarily act with a view to cause damage to the other party.[18] Establishing that the person has acted in a malicious way in the context of autonomous guarantees and *a fortiori* in relation to a PPG will prove to be difficult. Indeed, Luxembourg (and other civil law jurisdictions) consider that it is not sufficient to evidence that there has been an abuse or a fraud to challenge the validity of the call, such fraud or abuse must be obvious (*manifeste*); it must be clear as day. The rationale of the courts is that if the courts need to make a detailed analysis of the situation by having to make certain checks in connection with the underlying debt, this will defeat the autonomous feature of the guarantee and ultimately its efficiency.

24. A parallel may be drawn with the Collateral Law which is well known for its robustness, its efficiency and its swiftness. Indeed, the Collateral Law gives the power to the pledgee to enforce its security without prior notice upon the occurrence of the enforcement events determined by the parties. Judges have systematically refused to acknowledge a fraudulent behaviour on the part of pledgees who enforce their security interest in accordance with the Collateral Law and the security agreement. Instead, they consider that if a damage is incurred by the collateral provider because of the enforcement, damages may be allocated to him. In one case known as the *Pillar* case, for instance, Luxembourg courts have considered that the pledgee had acted in a fraudulent way in accelerating the debt the way it did because the fraud was eye-popping.[19]

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18 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 665.

19 T.A. Luxembourg, 10 July 2013, *JTL*, 60/2018, 178, confirmed by the Court of Appeal, C.A., 12 July 2019, the facts of which may be summarised as follows: a bank established in Luxembourg (the "lender") granted a loan to a Luxembourg holding company (partly owned by the bank itself) to finance the acquisition of a Luxembourg real estate company (the "target"). The loan was unsecured. The borrower under the loan was merged into the target so that the target became the borrower under the loan. On the maturity date of the loan (i.e. 31 October 2008), the financial situation of both the borrower and the bank was bad. The borrower was unable to repay the loan and the lender had been granted a suspension of payments. The lender who indirectly held the target managed to enter into a transfer agreement with a third party purchaser in order to transfer the target and to refinance the initial loan. One of the terms of the refinancing was that the transferee of the target would grant a first demand guarantee to the bank as well as a full security package to the lender to secure the repayment of the loan by the target. The financing documentation contained certain conditions subsequent to be met by the borrower to be able to dispose of the funds under the loan. The conditions subsequent had to be complied with by 31 January 2009. The borrower failed to satisfy such conditions subsequent by that date so that on 3 February 2009 at 4:22 p.m., the lender sent a fax to the borrower to inform it of the fact that it had waived the conditions subsequent and had made the funds available to the borrower. On the same date at 5:10 p.m. (!), the lender sent another fax to the borrower to terminate the loan agreement and to accelerate payments thereunder. The lender immediately called the payment of the first demand guarantee and enforced the pledges. The Luxembourg Tribunal d'arrondissement ruled that "the rigorous nature of the autonomous guarantee does not authorise a malicious party to use it as a spoliation instrument [...] the guarantee call must therefore be rejected if it is manifestly fraudulous or abusive [...]" to annul the guarantee call and the enforcement of the Luxembourg pledges. It

25. *Guarantor*. PPGs may be granted by any person with legal capacity, including natural persons, either unilaterally or by order of a third party or a beneficiary.[20] Traditionally, when the surety was remunerated by the beneficiary of the suretyship, legal literature considered that the guarantee was not a suretyship but rather a credit insurance (*assurance-crédit*).[21] The fact that the payment of the guarantee may be requested by a beneficiary who paid the guarantor for its services shall not, as highlighted in the comments to the bill of law,[22] lead to a requalification of the PPG into a credit insurance if such guarantee is labelled as a PPG.

26. The bill of law initially limited the scope of the PPG Law to well-informed parties (hence the name of the PPG) to the exclusion of natural persons. Such a limitation was criticised by the State Council and the scope of the PPG Law was extended to allow natural persons to be guarantors. The reference to "professional" in the title of the PPG Law raised certain questions in so far as the State Council considered that it was disproportionate to forbid natural persons to be guarantors under a PPG be it in a professional context or in a private one.[23] The Luxembourg Finance and Budget Commission has however decided to restrict the scope of the PPG Law to guarantors acting in a professional context (including natural persons). Consequently, the title of the PPG Law remained unchanged.[24]

27. Given that a PPG may be modulated in a way which is extremely efficient towards the beneficiary like in the case of a first demand guarantee (waiver of defences, call on first demand, call without the need for any kind of justification, etc.) and no possibility to requalify the PPG into a suretyship or another type of guarantee more protective towards it, this type of guarantee may be quite onerous for the guarantor especially a non-sophisticated natural person, which is why it was thought prudent to exclude natural persons from the scope of the PPG Law. In any case, inexperienced parties to a PPG should carefully review the guarantee, seek advice to understand all of its consequences and clearly reflect the commercial agreement in order to avoid any misinterpretation, either between the parties or by a Luxembourg court.[25]

28. *Obligation of information*? Historically, professional beneficiaries did not have the obligation to warn non well-informed sureties of the risks incurred by them in granting the guarantee. The position of Luxembourg case law was always that if the beneficiary had the obligation to inform the surety of the

is crucial to note that it is not the call itself which was fraudulous but the events triggering the call of the guarantee.

20 Art. 4(1) of the PPG Law.

21 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 717.

22 *Ibid.*

23 *Doc. parl.* No. 7567, CE 60.198, State Council's advice, 4.

24 A. Canto, P. Dorin and S. Jacoby, "La nouvelle loi…", *op. cit.*, 12.

25 *Ibid.*, 11.

terms of the suretyship in order for the surety to provide its informed consent, it did not have the obligation to warn the surety of the financial situation of the debtor and of the potential risk of over-indebtedness incurred by it. Indeed, Luxembourg courts considered that the surety had the obligation to act diligently by seeking information on the financial situation of the debtor and of the consequences of the guarantee and that such obligation did not have to be borne by the bank, beneficiary of the surety.[26]

29. This position has however changed following the decision of the Luxembourg Cour de cassation of 21 January 2016 in respect of a decision of the Court of Appeal dated 21 January 2015 where the latter ruled that the bank had no warning obligation in the context of a suretyship.[27] The High Court sanctioned the decision of the Court of Appeal by ruling that "instead of searching whether X was a non well-informed surety and, if that was the case, if the bank had complied with its obligation of warning the surety in light of the financial capabilities of the surety and the risk of over-indebtedness borne by him, according to the warning obligation of the bank existing at the time of the entering into the suretyship agreement, the Court of Appeal has violated [Article 1147 of the Luxembourg Civil Code]".[28] Pursuant to this decision, professional beneficiaries must check whether the surety is well-informed or not and if not well-informed they must adapt the degree of information given to the surety. Two points must be stressed: the professional beneficiary has not only an information obligation but also a warning obligation towards the surety and the burden of proof will be borne by it. On the latter point, French case law (based on which the Luxembourg Court took its decision) considers that there is a presumption that the surety is not well-informed.

30. The situation for autonomous guarantees is not well defined. Legal literature is in favour of such a warning obligation from the professional beneficiary given that autonomous guarantees are more stringent than suretyships for the guarantor. Recent French case law[29] considered on the contrary that due to the autonomous feature of the guarantee, no such obligation existed for the professional beneficiary.

31. A couple of issues come to mind in connection with this warning obligation. A difficulty arises in respect of the compatibility of the warning obligation with the professional secrecy obligation of the bank, beneficiary of the suretyship. How can a bank warn a surety of the financial condition of the debtor without violating its professional secrecy obligation? Specific waivers shall be foreseen in that respect. Another issue relates to the fact that French courts have not clearly determined the criteria for considering whether

[26] See in that sense, C.A., 14 March 2001, No. 21151.
[27] C.A., 21 January 2016, No. 3564; 13/16, *JTL*, 5/2016, 135.
[28] Cass. lux., 21 january 2016, No. 3564; 13/16.
[29] Cass. fr. com., 30 January 2019, No. 17-21.279, *Bull. civ.*

a guarantor is well-informed or not. This entails therefore a heavy formalism for the professional beneficiary of the guarantee who shall elaborate specific checklist to be filled in by the guarantors to assess their degree of awareness and ensure that they keep a written record of the formalities accomplished in that respect.

32. The PPG Law does not provide for an information or a warning obligation of the guarantor. Does it mean that such obligations shall be excluded from the scope of the law or would it be preferable to consider that a professional beneficiary should comply with this obligation to be on the safe side? Given that the primary intention of the legislator was to exclude natural persons from the scope of the PPG Law because such natural persons are presumed not to be well-informed, we are led to believe that the silence of the legislator shall be not be interpreted as expressly excluding the warning obligation, especially when the guarantor is not experienced.

33. *Beneficiary*. A PPG may be granted in favour of any person including persons acting on behalf of the real beneficiaries, fiduciaries and trustees provided that the beneficiaries are determined or determinable.[30]

34. The PPG Law affords "the persons acting on behalf of the beneficiaries of the professional payment guarantee, the fiduciary or the trustee […] the same rights as those conferred on the direct beneficiaries of the professional payment guarantees […], without prejudice to their obligations to third-party beneficiaries of the professional payment guarantee". This express recognition shall have a practical interest because as pointed out by certain authors,[31] the question of whether the beneficiary of the guarantee may be another person than the creditor of the underlying obligation has raised questions in the past. Indeed, prior to the entry into force of the Collateral Law where a similar approach was adopted, parties to security agreements had to use the mechanism of parallel debt or resort to the concept of "mandate" to grant security to the security agent over rights *in rem*, which was not ideal. The PPG is quite attractive in this respect, like the Collateral Law and aeroplane mortgages (*hypothèques sur aéronefs*) which are the only regimes for which such a mechanism exists.[32]

35. *Rights of recourse*. Whilst the situation of the guarantor under a suretyship is clear in that it benefits from a personal right of action (*droit de recours personnel*) against the principal debtor to recover amounts paid by it, the rights of the guarantor under an autonomous guarantee are less clear. Legal doctrine and case law debate whether the autonomous nature of the guarantee constitutes an obstacle to the creation of a direct right of recourse against the debtor of the underlying obligation. Conversely, since the underlying obligation is the reason or cause for entering into the autonomous guarantee in the first

30 Art. 4(3) of the PPG Law.
31 A. Canto, P. Dorin and S. Jacoby, "La nouvelle loi…", *op. cit.*, 11.
32 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 719.

place, there is no reason to object to a direct right of recourse in favour of the guarantor. Dealing with this issue contractually may also prove difficult without prejudicing the autonomous nature of the guarantee.

36. A Luxembourg court acknowledged the fact that "it is accepted in doctrine that the guarantor has a right of action against the principal debtor based on the instruction of the latter. If the guarantor has properly performed his obligation, the right to claim payment from the principal debtor is justified".[33] The Luxembourg Court of Appeal considered in its most recent jurisprudence that "the autonomy of the first demand guarantee entails that the guarantor who paid does not have a direct and automatic right of recourse against the principal debtor".[34] The majority of the legal literature considers, in turn, that guarantors and especially professional guarantors such as banks should have a remedy against the principal debtor for which they should not ultimately bear the economic risk. This position reinforces the argument pursuant to which autonomous guarantees have a proper cause: that of being repaid. Indeed, there have been certain discussions among legal authors in the past to determine whether an autonomous guarantee had a cause. In this respect, Luxembourg courts have determined that "the existence of an underlying agreement, already executed or most of the time in draft form, constitutes the reason for having a guarantee. It is more precisely the cause of the guarantee. There cannot be a guarantee without an obligation to guarantee."[35] Professional guarantors and others do not act with the intention of making a donation (*faire une libéralité*) to the principal debtor. The question debated in doctrine is therefore that of the legal justification for the existence of such a remedy right. Certain authors claim that the guarantor acts pursuant to a mandate without representation (*mandat sans représentation*) which must necessarily exist in the sense that a guarantee is never granted without the order from a principal. Other authors claim that a guarantee is always granted in consideration for the compensation that the principal debtor will owe the guarantor following payment of the guarantee. A contract between them is therefore deemed to exist when the guarantee is granted and will constitute the basis for the legal action held by the guarantor against the principal debtor.[36]

37. This uncertainty does not exist in respect of PPGs since Article 4(5) of the PPG Law expressly provides that "unless otherwise agreed by the parties, following payment, the guarantor will benefit from a right of recourse against the principal […]".

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33 Trib. arr. Luxembourg, 9 March 2005, Nos. 83780 and 84852.
34 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 679.
35 *Ibid.*, 631.
36 *Ibid.*, 680.

38. *Subrogation.* The right of the guarantor to be subrogated in the rights of the beneficiary of the guarantee exists in relation to both the suretyship (Article 2029 of the Luxembourg Civil Code) and the autonomous guarantee (developed by case law on the basis of Article 1251-3° of the Luxembourg Civil Code).

39. The guarantor in the context of a PPG is also subrogated in the rights of the beneficiary up to the amount paid unless otherwise agreed contractually.[37]

40. *Insolvency proceedings.* Article 4(6) of the PPG Law is an application of Article 4(4) in the sense that anything that may affect the underlying guaranteed obligations could constitute an exception for the guarantor to refuse payment under the guarantee. Hence, the legislator made it clear that the obligations of the guarantor under the PPG shall remain unaffected despite the fact that the underlying guaranteed obligation may be affected, e.g. restructuring, reduction, compulsory conversion, in the context of insolvency proceedings or other situations affecting creditors' rights generally.[38]

41. The PPG Law provides however for an exception being the case where the principal debtor is subject to an over-indebtedness procedure governed by the law of 8 January 2013 on over-indebtedness. Such law only applies to natural persons in the context of non-professional operations and provides for certain mechanisms aiming at improving the financial situation of the over-indebted debtor by accepting debt forgiveness, rescheduling of the debt or a reduction of the interest applicable. Article 41(2) of the law of 8 January 2013 provides that the above-mentioned measures shall also apply to the guarantors, co-borrowers and other obligors.

42. *Termination.* Total freedom is given to the parties to a PPG to determine the conditions for its termination. The parties are therefore free to choose that the guarantee will be terminated upon termination of the principal debt or that it will be terminated upon certain conditions completely independent from the underlying obligation. Should the PPG agreement not contain specific termination events, civil common rules on termination will apply to it.

43. *The remaining uncertainty in respect of the rights held against the debtor before and following payment.* Regrettably, the legislator who solved many practical questions in the PPG Law remained silent on the existence of remedy rights against the debtor, be it before payment or after payment. Articles 2032[39] and

[37] Art. 4(5) of the PPG Law.

[38] *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 8.

[39] Art. 2032 of the Civil Code provides that: "The surety, even before having paid, may act against the debtor to be indemnified by him: (1) when he is sued for payment; (2) when the debtor has gone bankrupt or is in bankruptcy; (3) when the debtor is obliged to give him his discharge within a certain period of time; (4) when the debt has become due and payable by the expiration of the term under which it was contracted; (5) after ten years, where the principal obligation has no fixed term of maturity, unless the principal obligation, such as a guardianship, is of such a nature that it cannot be extinguished before a specified time."

2039[40] of the Luxembourg Civil Code provide for certain rights of action of the surety (*caution*) against the debtor before payment. Article 2028[41] of the Luxembourg Civil Code also provides for a personal remedy right against the principal debtor, following payment.

44. Is the silence of the legislator supposed to be interpreted as specifically excluding a right of recourse against the debtor? The legislator has been so foreseeing with respect to the other features of PPGs that it would be odd to consider that this is just an oversight. The bill of law is also quite laconic on this point since its only comment was to say that the parties are free to modulate this right freely or to exclude it.[42] One could argue that the legislator has specifically excluded a remedy right for guarantors against the debtor. Conversely, one could argue that the expressed will of the legislator is to provide for great contractual freedom in the context of PPGs; the parties should therefore be able to foresee remedy rights against the debtor before or following payment.

Section 3. Guarantee Users Are at a Crossroad…

45. The choice of the type of guarantee is dictated by the legal effects and the level of protection that the parties wish to achieve. Various factors will play an important role in determining the type of guarantee such as the nature of the contracting parties (professional vs non-professionals or even consumers), their commercial bargaining power as well as regulatory, legal or operational reasons or even market practice prevailing in some sectors.

46. Whereas in some instances the guarantee arrangement is intended to be protective of the beneficiary's position, in which case the autonomous guarantee is more appropriate, in other instances the parties will seek a more balanced or guarantor friendly position, in which case a suretyship is available and in yet other instances hybrid arrangements, combining features of both the autonomous guarantee and the suretyship, are sought but cannot be achieved without a residual risk that the arrangement is not recognised in accordance with its terms.[43]

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40 Art. 2039 of the Civil Code provides that: "A simple extension of the term granted by the creditor to the principal debtor does not relieve the guarantor, who may, in this case, sue the debtor to force him to pay."

41 Art. 2028 of the Civil Code: "A guarantor who has paid has recourse against the principal debtor, whether the guarantee was given with the knowledge or without the knowledge of the debtor. This recourse is for the principal sum as well as for interest and costs; nevertheless, the guarantor has recourse only for the costs incurred by him since he denounced the proceedings against him to the principal debtor. He also has recourse for damages, if any."

42 *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 8.

43 The discussion and comparisons deliberately focus on suretyship and autonomous guarantee since these forms of guarantees are most commonly used but it is to be noted that the effects of a guarantee can be achieved (to a greater or lesser degree) via other legal mechanisms or undertakings, e.g. joint liability, letters of intent, indemnities, insurance, covenants to pay, trade bills.

47. The creation in the late 1970s of the autonomous guarantee regime, which up until today remains a case law based regime, was prompted by the need to circumvent certain limitations and the guarantor-friendly nature of the suretyship regime. However, the autonomous guarantee regime remains limited in practice in the sense that its recognition depends on its autonomous nature, which in turn, requires strict drafting leaving little room for contractual freedom.

48. There has been extensive case law on the topic of guarantee requalifications since a landmark ruling (*arrêt de principe*) of the French Cour de cassation of 13 December 1994[44] whereby the French judges considered that notwithstanding the fact that the guarantee included a wording pursuant to which the guarantee constituted "an autonomous guarantee undertaking to be performed on first demand"[45] the guarantee documentation also mentioned the fact that the purpose of the guarantee was to cover the payment of "all sums owed by the debtor"[46] so that it should be requalified into a suretyship rather than a first demand guarantee. The argument of the French court was that by referring to the underlying debt, the guarantee could not be autonomous. The conclusion of this determining ruling is that the qualification of the parties does not matter, "an error of labelling, conscious or not, does not modify the contents of a bottle; consequently, using an improper terminology shall not result in having another legal regime applied to the relevant legal operation".[47]

49. Luxembourg case law is sometimes unclear and shows that there is "a risk of confusion between the autonomous guarantee and the suretyship, risk all the more important is the absence of a clear distinction criterion".[48] Luxembourg courts have not always identified homogenous criteria to establish whether a guarantee should qualify as autonomous guarantee or suretyship. Indeed, Luxembourg courts considered that a guarantee should be characterised as being autonomous despite the fact that it referred to the underlying debt as long as it was irrevocable, that the guarantee referred to a fixed amount and that the guarantor had waived its defences.[49] On another occurrence, Luxembourg courts considered that conditioning the call of the guarantee to the production of a certification that the customer of the guarantor "had not fulfilled its obligations" towards the beneficiary of the guarantee whilst all the other elements of the guarantee pointed towards an

[44] Cour de cassation, Chambre commerciale, 13 December 1994, No. 92-12.626, *Bulletin*, 1994, IV, No. 375, 309.

[45] We are translating.

[46] We are translating.

[47] L. Josserand, *Les mobiles dans les actes juridiques du droit privé* (Paris, Dalloz, 1928) No. 320, 400. We are translating.

[48] G. Minne, "Le risque de la requalification d'une garantie autonome en cautionnement" (2013) 51 *Bulletin Droit et Banque*, ALJB 44.

[49] Trib. arr. Luxembourg, 9 March 2005, Nos. 83780 and 84852.

autonomous qualification was not enough to consider that the guarantee was autonomous.[50] In another case, the Court of Appeal considered that a guarantee should qualify as being autonomous despite the reference to the principal obligation in light of all the other criteria showing that the guarantee was meant to be autonomous (for instance, the use of the adverbs "irrevocably" and "unconditionally" to describe the guarantee and the fact that the guarantor had waived all its defences under the agreement).[51] In this case, the Court of Appeal stated that "there cannot be a guarantee in the absence of an underlying obligation to guarantee. Autonomy [of the guarantee] does not mean absence of a reference to the underlying agreement."

50. Oddly enough, the Court of Appeal decided in another case to requalify a guarantee stipulated as being a suretyship into a first demand guarantee.[52] The Court of Appeal based its decision on the other elements of the guarantee arrangement that it construed as revealing an autonomous nature which prevailed over the qualification given by the parties in the guarantee documentation.

51. While a reference to the underlying agreement is generally accepted by Luxembourg courts for contextual purposes, a guarantee arrangement depending too much on the principal obligation will hardly qualify as an autonomous guarantee. Mixing features from both regimes is inconceivable "in the framework of traditional guarantees such as the suretyship and the autonomous guarantee, and this is an example of how practical the professional payment guarantee is".[53]

52. The mere reference in the PPG to the PPG Law as the governing law is sufficient to render ineffective the provisions of the Luxembourg Civil Code on suretyship irrespective of the terms of the guarantee itself. This provision shall undeniably warrant that the intention of the parties will be given effect to.

53. Consequently, it is hardly conceivable that parties that would normally resort to a proper autonomous guarantee would not instead make the guarantee subject to the PPG Law simply to avoid any risk of requalification and without, however, changing the nature and the other terms of their usual guarantee.

54. Similarly, where the agreement between the parties to the guarantee want to set up a guarantee that is similar to a suretyship but without constituting a suretyship subject to Articles 2011 to 2020 of the Civil Code, a PPG would allow the parties to freely modulate the guarantee without having to respect the legal conditions imposed by the above-mentioned articles.

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50 C.A., 13 June 2012, No. 37117; see also G. Minne, "Le risque de la requalification…", *op. cit.*, 39–46.
51 C.A., 19 December 2012, No. 36931.
52 C.A., 18 March 2009, No. 32061.
53 H. Westendorf, *Les sûretés et garanties en droit luxembourgeois*, *op. cit.*, 714. We are translating.

55. Therefore, it is easy to conceive that the PPG will overshadow the Luxembourg traditional guarantee regimes.

Chapter II. Selected Examples

56. After having defined what a PPG is and described its main features, it is interesting to see in which cases it could apply. We can think of many areas and situations where PPGs may replace suretyships and first demand guarantees. It would be virtually impossible to list all the situations in which PPGs may apply. We will therefore concentrate the analysis on a few cases only in the fields of financings (A), investment funds industry (B), commercial relationships (C), construction works and real estate (D), and transfer of risk operations and credit risk mitigation (E).

Needless to say that such examples are not meant to be exhaustive.

Section 1. The PPG as an Innovative Alternative to Traditional Guarantees in the Context of Financing Transactions

57. It is customary for banks to request personal guarantees and security interests to guarantee and secure the payment liabilities of the borrower and other obligors under the loan documentation. In Luxembourg, such guarantees usually take the form of suretyships or autonomous guarantees depending on the type of financing used, the amounts at stake, the bargaining power of the guarantor, the parties involved and the risk profile of the borrowers. Although there is no set rule for choosing a suretyship versus an autonomous guarantee or vice versa, we can see that suretyships are used in general in the context of "smaller" financings, national financing transactions or financings with French banks which are accustomed to the suretyship mechanism, whereas autonomous guarantees are usually granted in the context of cross-border financing transactions involving different international players. It is customary, in the latter case, for acquisition financing deals to be structured via English law governed facility agreements based on the LMA[54] standard documentation which includes the autonomous guarantee in the facility agreement directly or in US law governed facility agreements used in the context of private equity acquisition deals. Certain financing deals may also involve Luxembourg first demand guarantees depending on the commercial agreement of the parties.

58. Luxembourg became a hub for cross-border acquisition financing transactions given the robustness of the Collateral Law in the international landscape. The Collateral Law is indeed one of the most competitive laws for security interests in Europe by having a regime which: allows for great

[54] "LMA" stands for the Loan Market Association, a professional association based in London for bankers and market participants in the area of bank financing.

flexibility in the structuring of the security interests, is non-formalistic, offers protection to the creditors in case of insolvency of the debtors or other obligors, and permits a swift and efficient enforcement of the security interests. One of the goals of the Luxembourg legislator was to introduce a comparable regime for personal guarantees and this has been achieved by the PPG Law. One could therefore easily imagine replacing Anglo-Saxon guarantees in the framework of national and international acquisition financing transactions by PPGs which are flexible (given that parties are free to design the guarantee as they please), secure for lenders (given the insolvency remoteness of the guarantee and the absence of a risk of requalification) and not burdensome in terms of formalism (opt-in regime).

59. One of the areas in which we see a potential for growth of the PPG is in connection with securitisations in the context of the credit enhancement of a tranche of pool of assets of the securitisation vehicle. One of the tools used to enhance the credit rating of a tranche is the granting by a specialised entity (monoline insurance companies or the European Investment Bank group, for example) of a guarantee used to pay the principal and interest under the securities issued by the special purpose vehicle if it is not able to do so. Traditionally, such guarantees were granted under Anglo-Saxon laws given their structuring flexibility and efficiency. In light of Brexit, one may however question their efficiency in case of a litigation due to the *exequatur* procedures required for enforcement in Luxembourg. Having a competitive guarantee governed by an onshore law, which the PPG has the potential to do, would certainly be beneficial in this respect.

60. Similarly, traditional guarantees could be replaced by PPGs in the context of the credit enhancement of bond issues. The issuer will request the guarantor to provide a guarantee for the benefit of the bondholders should it default in paying accrued interest under the bonds. Such guarantee could take the form of a PPG.

Section 2. The PPG as an Interesting Tool for the Fund Finance Industry

61. The fund finance industry is ranked the world's second-largest fund domicile after the United States. Alongside traditional Luxembourg-domiciled undertakings for collective investment in transferable securities funds, there has been an expansion in Luxembourg-based alternative investment funds. Such growth in the fund industry led to a remarkable development in fund finance activity, certainly helped by the lender-friendly environment offered by Luxembourg. Fund financings are typically secured by a security package comprising security interests over the capital commitments of the investors of the fund as well as security interests over the bank account held by the fund, both governed by the Collateral Law. In addition to the pledge agreements, personal guarantees are often granted by the Luxembourg borrower funds for the benefit of the banks and documented either in the

facility agreement itself or in a standalone document usually governed by UK or US law. There is no reason for this guarantee not to take the form of a PPG in the future. In addition, it would be logical to have both the security package and the personal guarantee governed by the same law and be subject to the same courts.

62. PPGs may also be useful to guarantee a carried interest clawback. Indeed, the general partner of the fund (or the managers directly or through a dedicated vehicle) may be entitled to receive a promote known as "carried interest" (aka "carry") out of a waterfall allocating profits between the investors and the general partner of the fund. Depending on the metrics of the waterfall and the time the carried interest is payable, excess carry amounts may be paid. This case typically happens when the fund does not perform as forecasted at the beginning of its lifecycle and does therefore not generate enough distributions. A clawback is sometimes seen to oblige the carry recipients to return the portion of overpaid carried interest. The clawback mechanism may however not work as expected in the presence of multiple individuals because it is impossible to ensure a full repayment of the carried interest from all the carry recipients. To cater for this, a guarantee is sometimes put in place at the level of a group entity with better credit standing in order to ensure the due payment of the clawback. Practice has shown that it may be complex to find a Luxembourg guarantee which perfectly fits the needs of the parties because it is generally necessary to make a reference to the default under the clawback to be able to enforce the guarantee (an autonomous guarantee would therefore not be satisfactory as it would carry a risk of requalification) and a suretyship would not give the same level of protection given the possibility for the guarantor to raise defences in connection with the underlying instrument. The PPG would certainly be of use in such a case as it would allow the parties to implement a guarantee modelled on the underlying obligation (or at least on certain elements thereof) without incurring any risk of requalification and excluding the right to raise defences for the guarantor.

Section 3. The PPG as a Modern Guarantee Tool in the Context of Commercial Transactions

63. A plethora of risks may be guaranteed (mitigation of the insolvency risk of the parties, non-payment, non-delivery, delivery delays, non-conformity, loss or breakage of goods, etc.) in the context of national and international commercial transactions for which PPGs could replace traditional personal guarantees.

64. For example, shipment guarantees whereby the loss of equipment or goods during transportation would be guaranteed to the client, which took the form of autonomous guarantees historically, could naturally be replaced by PPGs.

Section 4. A Promising Future for the PPG in the Luxembourg Construction Sector

65. Construction (and real estate in general) is a booming sector in Luxembourg. Ensuring, inter alia, that tenders go through as planned and that agreements will be performed within the agreed timeframe and according to the terms of the contract are key to support these dynamic sectors. It is therefore common to grant guarantees like tender guarantees (*garanties de soumission*) or performance bonds (*garanties de bonne fin*).

66. Tender guarantees (also known as bid bonds) are requested from tenderers in order to protect the contracting party from bids from unreliable or unqualified partners and against a sudden termination of the bidding process from a tenderer who would no longer be interested in the project or incapable to deliver. The analysis of tender offers is often a long and expensive process for the contracting party so that it must get comfort on the financial, technical and professional robustness of the tenderer. Bank guarantees are given to the recipients of the tender offer in order to comfort them and to shield them from a withdrawal or an amendment of the tender before the end of the validity period of the bid or if counterparty refuses to enter into the contract after winning the tender. The guarantee will be issued for an amount generally of up to 5% of the value of the tender. Tender guarantees take the form of autonomous guarantees which can be quite heavy for the guarantor since the beneficiary could use the autonomy of the guarantee to request an extension of the guarantee. This so-called "extend or pay" technique permits the beneficiary to threaten the guarantor to pay the guarantee if it does not consent to an extension thereof.[55] Now, it is common to have a situation where the negotiation process lasts longer than the initial term agreed between the parties to the tender. With a PPG, it would be possible to contractually determine the conditions of an extension by referring to the underlying payment obligation, if necessary, without risking a requalification of the guarantee into a suretyship. The guarantee would be safer for the guarantor and for the beneficiary.

67. Performance guarantees (*garanties de bonne fin/garanties de bonne exécution*) are a type of guarantee intended to cover the absolute compliance and make-good obligations of a contractor until the achievement of the relevant construction. It will be callable at the end of the construction if such construction is non-compliant with the specifications (*cahier des charges*). The guarantee will be callable by the beneficiary at the time of the delivery of the construction works. The guarantee is sometimes under the form of a suretyship (especially in France, *caution de bonne fin*), sometimes under the

[55] A. Prüm, *Les garanties à première demande : essai sur l'autonomie* (1st ed., Paris, Litec, 1994), 129–133; see also P. Simler, *Cautionnement, garanties autonomes, garanties indemnitaires* (3rd ed., Paris, LexisNexis, 2000) 865–867.

form of a first demand guarantee or justified first demand guarantee. The suretyship mechanism may not be protective enough for the beneficiary since the guarantor can raise defences to avoid paying the guarantee. Such defences could consist, for example, in the late payment of the tranches for the works by the project owner or a violation by the project owner of his contractual obligations. Given the amounts at stake, this is not a satisfactory solution. A first demand guarantee is more protective and easy to call if it is well drafted by the parties. Here again, a PPG could gap the weaknesses of both regimes.

68. The advance-payment guarantee (*garantie de restitution d'acompte*) is a guarantee used in connection with construction works for which the client has to make a down payment to the contractor to help him meet start-up and procurement costs – which can be quite significant – before the construction work begins. If the contractor fails to honour his contractual obligations or becomes insolvent, a third party guarantor (in general a bank) will have to repay the advance made by the client. Traditionally, first demand guarantees were granted in order to ensure a swift repayment of the advance made by the client. A question remained however as to whether the advance-payment guarantee could be used to challenge the use of the funds advanced by the client or only the fact that the construction work could not be realised.[56] The autonomous feature of the first demand guarantee can only trigger a repayment of the advance if the construction is not completed but it cannot be used to cover a misuse of the deposit. Another important issue with this type of guarantee is that the amount guaranteed should in principle diminish as things progress but the autonomy of the guarantee implies that the guarantor cannot refer to the underlying obligation to reduce the quantum of the guarantee, it will therefore need to be held accountable for the whole amount until the termination of the guarantee. Submitting the guarantee to the underlying contract will necessarily imply a risk of requalification of the guarantee into a suretyship which is less protective for the beneficiary. A PPG could easily resolve these issues.

69. Equipment guarantees are similar to advance-payment guarantees but instead of making an advance to the contractor, the client will lend the equipment necessary for the works to the contractor and the guarantee is therefore granted to the client to cover the risk of destruction or alteration of such equipment. Here again, a PPG could apply.

70. *What about the full completion guarantee (*garantie d'achèvement*)?* In substance, full completion guarantees must, by law,[57] be given by the seller of a residential building which is yet to be built (*vente en état futur d'achèvement*, "VEFA") to the purchaser of such a property to protect the latter from the risk

[56] A. Prüm, *op. cit.*, 79.
[57] Art. 1601-5 Civil Code.

of non-completion. Article 1601-5 of the Luxembourg Civil Code provides that the form of the guarantee shall be fixed by Grand-ducal regulation. The Grand-ducal Regulation of 3 October 1978 (the "VEFA Regulation") foresees in its Article 2 that the guarantee shall either (i) be in the form of a credit line by which the person granting such credit facility will provide the funds necessary to finish the construction to the seller of the property or pay in lieu and place of the seller directly; or (ii) be in the form of a suretyship whereby the surety and the seller of the property will be jointly and severally bound to pay the construction works. The form of the guarantee being imposed by law, it should in principle not be possible to use another form of guarantee such as a first demand guarantee or a PPG. It is interesting to note that the legal regime of the full completion guarantee is not completely respected in practice. Indeed, Article 1 of the VEFA Regulation only allows banking and saving institutions to grant full completion guarantees but insurance companies often grant them as well. The Luxembourg insurance sector regulator[58] even issued (unsuccessfully) a circular[59] reminding insurance companies that they were not supposed to grant this type of guarantee. This makes us wonder whether there could be any room in practice to use PPGs instead of sureties in the future. Joint and several suretyships are quite robust because the benefit of discussion and the benefit of division are set aside which leads us to think that the intention of the legislator was to grant great protection to the buyers of future constructions and therefore that a PPG could satisfy that.

71. The same question applies for all other types of legal guarantees. It would certainly be worth having the legislator extend the scope of legal guarantees to cover PPGs.

Section 5. The PPG as a Satisfactory Tool for Credit Transfer Risk and Risk Mitigation Operations

72. One of the areas mentioned in the bill of law as being one of the areas in which PPGs may apply is that of risk mitigation and risk transfer operations which are notably used in the context of support for SMEs and Small Mid-Caps[60] across Europe. As mentioned in the bill of law,[61] personal guarantees constitute a very important tool for financial operations promoted by the European Commission through the capital markets union notably. Such operations are carried out by national and European institutions, such as the European Investment Bank and the European Investment Fund (the "EIB Group") by the provision of guarantees qualifying as unfunded credit protection under Regulation (EU) No. 575/2013 of the European Parliament

58 The Commissariat aux assurances (CAA).

59 Circular 16/6 of 26 April 2016.

60 As defined by the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (*OJ* L 124, 20 May 2003, 36–41).

61 *Doc. parl.* No. 7567/00, explanatory statement of the bill of law, 1.

and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (the "CRR"). Unfunded credit protection is defined by Article 4 of CRR as "a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified credit events", in other terms, unfunded credit protection consists in guarantees. We note from the websites of the members of the EIB Group that they act as guarantors or counter-guarantors in the context of portfolio guarantees whereby they provide a guarantee (or counter-guarantee) to certain selected financial intermediaries by way of a call for expression of interest in order to guarantee a portfolio of loans or other financial instruments granted to SMEs or Small Mid-Caps by such financial intermediaries at better lending compared to standard credit policies and procedures applicable to borrowers having a comparable risk profile.

73. The benefits of the guarantees granted by this type of European institution are considerable for the European macroeconomy: they enhance access to financing for SMEs and Small Mid-Caps complying with certain eligibility criteria at favourable lending conditions (reduced interest rates, reduced collateral requirements, extended maturities and grace periods) whilst qualifying as unfunded credit protection for financial intermediaries. The latter point is important, as it will alleviate the capital requirements of the financial intermediaries.

74. We note from the term sheets available on the websites of the EIB Group that certain guarantees shall be governed by English law whereas other guarantees shall be governed by Luxembourg law. One can perfectly imagine that such Luxembourg law guarantees be structured under the form of PPGs as suggested in the comments of the bill of law in relation to portfolio guarantees.[62] When looking at the term sheets of the Luxembourg guarantees available on the website of the European Investment Fund, we note that the guarantees will cover the defaulted amounts in the portfolio of financial instruments granted to the SMEs or Small Mid-Caps but the guarantees will be callable by the financial intermediary even before the borrowers have defaulted. The PPG call regime will certainly be a great tool to manage guarantee calls under the portfolio without incurring any requalification risk. The freedom given to the parties to structure such complex guarantees will certainly be extremely useful in this field.

[62] *Doc. parl.* No. 7567/00, comments to the articles of the bill of law, 8–9.

Conclusion

75. PPGs certainly have the potential to overcome the shortcomings of traditional Luxembourg personal guarantees and to render them obsolete. Their enhanced legal security, the great contractual freedom they give to the parties and their light formalism undoubtedly constitute formidable attributes for legal practitioners in the context of national and cross-border transactions.

76. Like security interests regulated by the Collateral Law, they can become a very successful creditor-friendly tool and put Luxembourg on the map in this respect.

77. The only obstacle we see to the expansion of the PPG is force of habit. Indeed, practitioners may want to stick to what they know and consequently not give the PPG a chance.