
THE MERGERS & ACQUISITIONS REVIEW

THIRD EDITION

EDITOR
SIMON ROBINSON

LAW BUSINESS RESEARCH

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THE MERGERS & ACQUISITIONS REVIEW

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PREFACE

The past year has seen the financial crisis continue to escalate. Financial markets have witnessed a number of events that have had global effects, from the collapse of Lehman Brothers in September 2008, to Iceland's banking crisis and the nationalisation of various financial institutions by several governments. The consensus is that the decision not to rescue Lehman was a mistake, although, to date, this appears to be an isolated – if serious – error by the authorities in response to the banking sector crisis. Other responses to these turbulent market conditions include the decision to reduce interest rates to historically unprecedented levels and massive fiscal stimulus in many countries. More controversially, several monetary authorities have implemented a 'quantitative easing' policy. Taken together, these efforts seem, at the moment anyway, to have averted a full-scale depression, but this has clearly been achieved at the price of huge public-sector deficits and substantial debt burdens for future generations.

The current debate centres around whether the next stage will be a continuing crisis, a return to 'normality' or, as seems more likely, a slow and anaemic recovery. In any case, many observers predict significantly higher levels of inflation than seen in recent years. Although some tentatively predict that a recovery from the financial crisis is on the horizon, the topic remains one of ferocious debate.

Some questioned whether the banking crisis would seriously affect the wider economy. The last year has proved beyond doubt that those who predicted a wider financial crisis were correct. The crisis in the real economy has much further to run and a significant increase in unemployment, particularly in Europe, regrettably seems inevitable.

M&A activity has reflected this crisis. Lending remains very constrained and the most significant activity has been in the financial sector, although property companies are also severely stressed. The less welcome development over the past year or so has been the steady stream of distressed corporate rescues, some by takeover. More optimistically, many are now commenting that, for those with cash, there are bargains to be had.

From the lawyers' perspective, the next stages are likely to be of great interest as the authorities take steps to rebuild confidence in financial institutions. The regulatory architecture will change significantly, although the final form is not yet obvious.

I again wish to thank all the contributors for their continued support and cooperation – and all the unnamed others who have helped to produce this book, which, given the current economic climate, should hopefully provide interesting reading.

Simon Robinson
Slaughter and May
London
August 2009

Chapter 37

LUXEMBOURG

*François Brouxel and Sufian Bataineh**

I OVERVIEW OF 2008/2009 M&A ACTIVITY

The growth of M&A activity remained relatively strong in Luxembourg in 2008 and 2009, despite the global financial disturbance and its spread to economies around the world. Luxembourg started to feel the heat of the financial crisis in its economy in August 2008, together with financial scandals affecting the markets such as the Madoff case.

As a result, Luxembourg M&A activity declined to some extent, mainly due to the risk of a large bank sector failure. We have noticed that Luxembourg banks have been affected severely by the financial crisis. The fund investments industry, however, took advantage of this sceptical period and has achieved good results so far.

Luxembourg is the largest investment funds centre in Europe and the world's leading hub for global fund distribution, therefore, the investment funds industry played a major role in stabilising the Luxembourg market, with newcomers such as infrastructure funds and sovereign wealth funds joining the traditional real estate, private equity and hedge funds already strongly present on the market. Long known for its flexibility, Luxembourg is ideally placed to implement tax-efficient M&A transactions. After SICAR¹ and securitisation vehicles, the launching of SIFs² and SPFs³ in 2007 were well-suited to mitigate the harshness of the financial crisis on the Luxembourg economy.

Given the current cautious attitude of the global financial markets and the negative sentiment of investors after a series of financial scandals, investment funds took advantage of the present financial crisis by targeting distressed investments across

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1 *Société d'investissement en capital à risque.*

2 Specialised Investment Fund.

3 *Société gestion de patrimoine familial.*

different sectors including financial services, automotive, consumer products and retail. The most common distressed investment is the purchase of debt securities issued by financially troubled or bankrupt companies at a substantial discount of face value. Investment funds, after effecting appropriate reorganisation of the distressed company acquired, replace the debts with new securities issued by a financially stronger company. We even noted that some funds targeted the US market, given the lack of visibility into earnings caused by the current economic environment there.

In addition to the distressed investments, as there are relatively few M&A deals in the pipeline given the lack of financing from banks, some funds found attractive opportunities in arbitrage situations of companies with fairly predictable cash flows, strong balance sheets and little debt.

Apart from the activities in the investment funds industry, some M&A transactions took the form of a takeover bid. In May 2009 the French bank BNP Paribas officially took control of Fortis Bank Belgium and Fortis Bank Luxembourg activities.

One of the hot topics in Luxembourg, as will be discussed *infra* in detail, is the acquisition of Kaupthing Bank Luxembourg SA by Blackfish Capital. This bank was one of the active players in the Luxembourg financial arena, which suffered severe losses as a result of the financial crisis.

Furthermore, as most of the high-profile group of companies have a presence in Luxembourg, the financial crisis required most of them to conduct a general audit of their activities, and to alter any reorganisation, merger, acquisition, reverse acquisitions to be less exposed to the effects of the crisis.

II GENERAL INTRODUCTION TO THE LEGISLATIVE M&A FRAMEWORK

On 6 May 2009 the Luxembourg Parliament passed Bill No. 5829 on cross-border mergers ('the Merger Law'), which was published in the Memorial on 29 June 2009. The Merger Law, in addition to its implementation of several provisions of EU directives, modifies the law of 10 August 1915 on Commercial Companies and the Labour Code.

The main aspects of the Merger Law are the following:

- a* Except in very specific cases, there is an obligation to prepare a report by a qualified auditor in the case of contributions in kind to a public limited liability company. Where the contribution in kind occurs without an auditor's report, a statement of contribution value shall be published within one month after the effective date of the contribution.
- b* Under certain conditions, the Merger Law introduces the possibility for a company to acquire its own shares, either itself or through a person acting in its own name but on the company's behalf, provided that prior authorisation has been given by a general meeting of shareholders.
- c* A company may, either directly or indirectly, advance funds, make loans or provide security, with a view to the acquisition of its shares by a third party.
- d* Clarification of the legal regime applicable to cross-border mergers:
 - 'draft terms of merger' gives way to 'common draft terms of merger';

- additional information is to be published in the case of a cross-border merger;
 - neither an examination of the common draft terms of merger by independent experts nor an expert report is required if all the shareholders of each of the companies involved have so agreed;
 - a specific regime is applicable if the merger is made through the incorporation of an European company; and
 - clarification of the determination of the date of entry into effect of the cross-border merger *vis-à-vis* third parties.
- e The possibility for a company to proceed to a demerger without being dissolved, that is, the introduction of ‘partial demergers’ under Luxembourg law.

Besides the new-long-awaited Merger Law, reference should be made to the Luxembourg Civil Code, which provides the principles applicable to contracts in general (validity of contracts, contractual liability, property rights), specific contracts (sale agreements, encumbrances, rights in rem, etc.), as well as fundamental corporate law principles.

With respect to secured deals, the law of 5 August 2005 on financial collaterals governs standard securities, such as pledges, with the notable effect of protecting the pledgees against the potential detrimental effects of bankruptcy situations affecting pledgors.

The law of 10 August 1915 on Commercial Companies, as amended is the corporate law text of reference. It contains, *inter alia*, the rules governing the mergers and demergers.

Implemented in urgency in the turmoil of the *Mittal-Arcelor* takeover bid, the law of 19 May 2006 concerning takeover bids (‘the Takeover Law’) is a close transposition of the Directive 2004/25/EC.

The law of 11 January 2008, on transparency requirements for issuers of securities (‘the Transparency Law’), which is a close transposition of Directive 2004/109/EC of 15 December 2004, contains the relevant provisions applicable to the acquisition or disposal of Luxembourg listed companies. The Transparency Law contains the rules governing the notification requirements when specific thresholds of voting rights are reached as a consequence of a disposal or an acquisition of listed shares. It also provides for the disclosure of information about issuers.

The law of 9 May 2006, on market abuse, aims to prevent insider trading and market abuse.

The law of 10 July 2005, on prospectuses for securities, contains the prospectus requirements that could *inter alia* apply where new shares are issued in consideration of a takeover (‘the Prospectus Law’).

It should be noted that M&A activities in Luxembourg may be subject to special regulatory controls or approvals according to their specific industry or activity. The most important is the Commission de Surveillance du Secteur Financier (‘the CSSF’), which is the Luxembourg authority in charge of supervising the financial sector and is also vested with the power to ensure compliance with the aforementioned laws (Takeover Law, Transparency Law, Prospectus Law).

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

The Takeover Law sets forth the main rules and the procedure applicable to takeover bids in Luxembourg. It provides, *inter alia*, the rules relating to general principles that have to be complied with, the rules for the determination of the competent control authorities, the applicable law, the protection of the minority shareholders, the mandatory bid and the price of the offer. The Takeover Law also sets forth the regime of squeeze-out and buyout.

The Merger Law, which entered into force on 29 June 2009, is expected to play a major role in enhancing M&A activity in Luxembourg. The scope of the Merger Law is broader than EU Directive 2005/56/EC itself, since the Merger Law permits mergers between a Luxembourg company and an EU company, and the Merger Law does not limit its scope to the European Union but enlarges it to third countries where such a cross-border merger is not prohibited by the law of the third country. This broader scope will give Luxembourg an advantage over other European jurisdictions and attract more investors to do business through Luxembourg.

The Merger Law is part of the Luxembourg regulatory environment, which has become more and more complex over the years. As a consequence of the current financial crisis, this environment is bound to get even more complex in the next couple of years.

Although regulation remains high on the agenda of financial institutions in Luxembourg, the Luxembourg financial industry will have to adapt to a number of a new regulations.

The legal and regulatory environment is largely determined by the numerous EC directives and regulations that have been adopted within the framework of the Financial Services Action Plan. Thus, the Luxembourg regulatory mechanism is completely in line with the European guidelines.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Luxembourg is a small country, where the financial sector is considered the largest contributor to its economy. Moreover, Luxembourg is the second-largest investment fund centre in the world after the US, the premier captive reinsurance market in the European Union, and the premier private banking centre in the Eurozone. As a result, the foreign involvement in M&A transactions is very high when looking at the main players in the Luxembourg financial market.

Luxembourg's nearest European neighbours are France, Belgium, Germany and the Netherlands, which are considered the main players in Luxembourg market and have a noticeable presence through their national banks and financial institutions. In addition, other European countries such as the UK, Italy, Sweden, Spain and others have a strong presence. We also note the presence of the main international financial institutions and banks of the US, Japan, Russia and China.

Furthermore, the Luxembourg market is still attracting more and more players from around the world. Investors from emerging countries in the Middle East and Latin

America have started to investigate the potential investment environment to expand their investments in Luxembourg.

Luxembourg has always been focused on attracting foreign investors by implementing an efficient, flexible and business-friendly legal environment, with the exception of European standards relating to anti-money laundering policy which constitute a guarantee for seriousness of the financial place, foreign involvements in M&A transactions are not subject to any other precise restrictions.

Luxembourg has a broad range of regulations adapted to foreign requirements. For instance, it is possible to express the share capital of the Luxembourg companies in foreign currencies or to have the corporate and contractual documentation directly drawn up in English.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

The current financial crisis created good investment opportunities for players who were not affected significantly by the crisis, targeting distressed investments and relatively healthy arbitrage situations, which have recently gained the attention of investors.

As noted *supra*, in May 2009 the French bank BNP Paribas legitimately took control of Fortis Bank Belgium and Fortis Bank Luxembourg activities. The deal closed after the retroactive approval with the European Commission of the aid of the Belgian and the Luxembourg governments during the nationalisation process of Fortis (Fortis Luxembourg bank changed its name into BGL following the nationalisation process in September 2008). Although the Commission authorised state aid, it stressed that BNP Paribas had agreed not to expand through banking acquisitions in Belgium or Luxembourg. By concluding this acquisition, BNP Paribas acquired a 75 per cent interest in Fortis Bank, which makes it the largest bank by deposits in the Eurozone. The Belgian state is now the largest shareholder in the French group BNP Paribas with 9.8 per cent of its share capital, while Luxembourg now has 1 per cent of its share capital with the right to vote.

Until recently, one of the hot topics in Luxembourg was the destination of Kaupthing Bank Luxembourg SA ('the Bank'), the Luxembourg arm of crisis-hit Icelandic bank Kaupthing. The Bank was one of the active players on the Luxembourg financial arena and suffered severe losses as a result of the financial crisis. In October 2008 the Commerce and Business Chamber of Luxembourg City District Court ordered the blocking of the accounts of the Bank as from 9 October 2008. Recently, in June 2009, the administrators and the management of the Bank announced that the interbank creditors voted on and approved the updated restructuring plan proposed by the Rowland Family *via* group company Blackfish Capital to acquire the Bank. The Bank administrators also received the approval of the Luxembourg Deposit Guarantee Scheme to participate in the funding of the restructuring of the Bank, and the approval of the Luxembourg Central Bank to agree on the repayment schedule of the outstanding financing facility. It seems that the Bank should obtain approval from the European Commission to finalise this transaction. The Bank will be renamed Banque Havilland,

and the fate of the 160 employees, who remained loyal to the Bank during this critical period, is still to be determined.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

For a number of reasons (low minimum share capital, closed character that reduces the anti-dilution risks, flexibility due to the non-application of the restrictions of the EC Companies Directives, US check the box benefit), the *société à responsabilité limitée* (private limited liability company) is the common corporate vehicle used for Luxembourg-structured acquisitions. For more complex structures, the *société en commandite par actions* is also a useful corporate form which combines limited and unlimited liability depending on the nature of the shareholders.

A mix of debt and equity is used at the Luxembourg level so as to finance, directly or indirectly, the acquisitions. Most notably, the debt-to-capitalisation ratio is interpreted in Luxembourg in a quite flexible way that allows for maximising the debt deductibility effect. In this respect, advanced tax agreements when granted by the Luxembourg tax authorities give an appreciable comfort to investors.

The financing of acquisitions by hybrid instruments, although commonly applied in practice by means of *sociétés à responsabilité limitée* raised legal issues as the legal provisions governing the *sociétés à responsabilité limitée* did not quite fit with practice. One of the features of Draft Bill 5730 on the Modernisation of Company Law is to allow all types of commercial companies vested with legal personality to proceed to the issuance of public or private bonds, in bearer or in registered form.

VI EMPLOYMENT LAW

The recent Merger Law amended the Luxembourg Labour Code with a new section devoted to the participation of employees within the framework of the merger process. The current Luxembourg legal provisions concerning the representation of employees in public limited companies will apply in the case of a cross-border merger.

This new section implements Council Regulation (EC) 2157/2001 of 8 October 2001 on the statute for a European company, by way of an extension of the cases for the representation of employees in Luxembourg companies, with the effect that:

- a* special provisions have to be set, mainly in the field of employee involvement; and
- b* in all Luxembourg public limited companies that employ regularly more than 1,000 employees, and in all Luxembourg public limited companies in which the participation of the Luxembourg state is more than 25 per cent, at least three directors representing the employees have to be appointed.

Thanks to the new Merger Law, if these two cases are not fulfilled, in the case of a cross border merger, the principle and modalities of article 12 of the Council Regulation EC 2157/2001 would have to be applied. Thus the special employee involvement implemented by Council Directive 2001/86/EC of 8 October 2001 supplementing the

Statute for a European company with regard to the involvement of employees would be applicable.

In addition, the company that will have been created pursuant to the merger will be bound to take adequate measures in order to ensure the rights of participation of the employees during the three years following the completion of the cross-border merger.

'Employee participation' does not mean participation in day-to-day decisions, which are a matter for the management, but participation in the supervision and strategic development of the company.

Several models of participation are possible: firstly, a model in which the employees form part of the supervisory board or of the administrative board, as the case may be; secondly, a model in which the employees are represented by a separate body; and finally, other models to be agreed between the management or administrative boards of the founder companies and the employees in those companies, the level of information and consultation being the same as in the case of the second model. The general meeting may not approve the formation of an SE unless one of the models of participation defined in Council Directive 2001/86/EC has been chosen.

The employees' representatives must be provided with such office space, financial and material resources, and other facilities as to enable them to perform their duties properly.

If the two parties do not reach a satisfactory arrangement, a set of standard principles set out in the Annex to Council Directive 2001/86/EC becomes applicable.

Employment contracts and pensions are not covered by Council Directive 2001/86/EC, and thus are not covered by the Merger Law.

VII TAX LAW

Luxembourg has always been on the forefront in terms of innovation, flexibility and pragmatic approach in the field of taxation matters. In line with this well-established tradition, the year 2009 proved to be remarkably fruitful in this respect with the implementation of the abolition of capital duty as of 1 January 2009, the withholding tax exemption of dividend distributions to treaty jurisdictions, the reduction of corporate income tax rate and the extension of the scope of the special tax regime for IP income.

i. Abolition of capital duty as of 1 January 2009

The 0.5 per cent capital duty with respect to contributions to the capital of Luxembourg companies was abolished as of 1 January 2009. The same applies to the fixed capital duty applicable to certain investment fund vehicles (SICAR, SIF, ASSEP,⁴ SEPCAV,⁵ and securitisation vehicles). In Circular No. 739 of 31 December 2008, the indirect tax authorities indicated that the five-year claw-back period foreseen under Article 4-2 no longer applies as of 1 January 2009 – even with respect to transactions that took

4 *Association d'épargne-pension.*

5 *Société d'épargne-pension à capital variable.*

place within five years preceding 1 January 2009. Article 4-2 deals with the ‘share for share’ merger exemption. Based on this article, a company receiving a contribution in kind consisting of shares in another EU company, in consideration for new shares in its own capital, would be exempt from capital duty under certain conditions. One of the conditions is a minimum holding period of five years. Otherwise, the capital duty becomes due. As from 2009, it will no longer be required for companies who benefited from this capital duty exemption in the past to keep the shares after 1 January 2009.

The capital duty was replaced by a fixed registration duty of €75 and will be due by civil or commercial companies upon their incorporation or the amendment of their bylaws under Luxembourg law or upon the transfer of statutory seat or place of central management by foreign companies to Luxembourg.

The contribution to a Luxembourg company of real estate assets situated in Luxembourg will be subject to the following regime:

- a* contribution of real estate assets to a company in exchange for shares will be subject to a 0.6 per cent registration duty and a 0.5 per cent transcription tax (resulting in a total levy of 1.1 per cent);
- b* contribution of real estate assets remunerated by other means than shares will be subject to a 6 per cent registration duty and a 1 per cent transcription tax (4 per cent in Luxembourg City, resulting in a combined rate of 10 per cent for real estate located in Luxembourg City); and
- c* transfer of real estate properties in the context of a corporate restructuring (such as the contribution of all assets and liabilities or one or more branches of activities) are exempt from the proportional duties. Such transfer must, however, be remunerated mainly (i.e., for more than 50 per cent) with securities that represent share capital in the contributee company.

ii Withholding tax exemption for dividend distributions to treaty jurisdictions

As of 1 January 2009, the exemption of dividend withholding tax provided for by Article 147 of the Luxembourg income tax law (‘ITL’) is extended to distributions made to fully taxable entities who are resident in a country with which Luxembourg has concluded a double tax treaty.

Such non-resident entities have to be fully taxable entities, i.e. subject to a corporate income tax that is ‘comparable’ with Luxembourg corporate income tax. Based on the commentaries to the draft law, a foreign corporate income tax is similar to Luxembourg corporate income tax if it is mandatory (i.e., not optional) and if the effective tax rate is at least half of the Luxembourg corporate income tax rate (i.e., 10.5 per cent as from 2009) and applied on a taxable basis that is determined following rules that are similar to the ones applicable in Luxembourg.

In addition, the withholding tax exemption requires that the participation in connection with which the distribution is made represents at least 10 per cent of the issued and outstanding capital of the distributing subsidiary, or has an acquisition cost of at least €1.2 million, and is held for a period of at least 12 months, before or after the distribution is made.

iii Reduction of corporate income tax rate

As part of the 2009 tax package, the Luxembourg government has decreased the corporate income tax rate by over 1 per cent bringing the aggregate corporate income tax rate (together with the municipal business tax and the mandatory contribution to the Employment Fund) down from 29.63 per cent to 28.59 per cent as of 2009 (for taxpayers established in the city of Luxembourg). The government has announced that it would pursue this trend in the next few years in order to reduce aggregate corporate income tax rate to approximately 25 per cent.

iv The broadening of the scope of the special tax regime for IP

With effect as of 1 January 2008, the 80 per cent income tax exemption of income and capital gains (with certain recapture rules for previously deducted expenses and amortisation) realised in connection with qualifying IP rights has been extended to include domain names. The reform has also introduced (with retroactive effect as of 1 January 2008) an exemption of qualifying IP rights from net wealth tax. This measure, combined with the 15 per cent standard VAT rate (the lowest rate in the EU) should boost the Luxembourg IP register and promote Luxembourg as a major hub for e-commerce and IT industry in general.

The EU Code of Conduct Group, which investigated the Luxembourg IP regime from a state aid perspective, came to the conclusion that the Luxembourg IP measure does not need to be assessed against the Code of Conduct criteria. This should encourage investors to make use of this measure.

IX COMPETITION LAW

Two distinct authorities deal with competition law in Luxembourg: firstly the competition council, which is an independent administrative authority ('the Council') and secondly the competition inspectorate, which is an agent of the Luxembourg Ministry of the Economy and Trade ('the Inspectorate') (together 'the Authorities'). The Authorities are members of the European Competition Network. The Inspectorate is in charge of investigating cases, whereas the power to order decisions, recommendations or penalties is attributed to the Council, acting as a public establishment independent from the political authorities.

Compliance with competition law principles within the framework of a merger is not specifically regulated in Luxembourg and Luxembourg law does not expressly grant power to any of the Authorities to investigate merger cases or to conduct pre-merger control.

Even though the Authorities are empowered to ensure that there are no agreements, decisions or practices that would prevent or restrict fair competition and, accordingly, the Authorities would be entitled to investigate mergers that could potentially breach the competition rules, in practice the Authorities have never used this power in the context of a merger. So far, the Authorities indeed consider that merger operations do not fall within the scope of their powers. As a result, there are no pre-merger filing or notification requirements under Luxembourg law, except for mergers that would have a European dimension. In this case, control is implemented at the level of the European

Commission, in particular on the grounds of EC Regulation 139/2004 of 20 January 2004. In such a scenario (as in, for instance, the *BNP Paribas/Fortis* deal), the European Commission could, in some cases, request assistance from the Authorities in respect of the Luxembourg competition law issues (as happened regarding the *Arcelor/Mittal* merger deal in 2007).

A project of reform is currently pending. With a view to optimising human and financial resources and to simplifying the administrative procedure, it is suggested to merge the two Authorities, the powers of the Inspectorate being transferred to the Council. The current reform project also foresees granting explicitly a consultative power to the Council concerning questions relating to competition law. However, it seems that the introduction of a merger control procedure in Luxembourg law is not covered by the current reform project.

X OUTLOOK

We believe that the outlook for M&A activities is positive despite the doubts raised by the disruption in global financial markets.

We expect a revival in M&A activity during the second half of 2009 at the earliest, and most likely in 2010, when economies begin pulling out of the downturn, we expect M&A activity to resume its rapid growth and continue attracting interest from investors.

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François Brouxel is a partner at Wildgen, where he co-heads the corporate department. He specialises in cross-border and domestic corporate and financial law. He is regularly involved in files dealing with mergers and acquisitions, banking and insurance advisory services, estate planning, capital markets and corporate litigation.

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