Is Luxembourg’s position as a financial centre driving disputes?

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GSK Stockmann’s Manuel Fernandez and Louis-Guillaume Roldan examine how Luxembourg’s particular characteristics might give rise to increased contention.

In any investment transaction or holding structure, the relevance of Luxembourg cannot be overestimated. The reasons for this are beyond the ambit of this article and they are in constant movement. However, these need to be quickly mentioned here because these are the very same sources that water the financial centre that also nourish the growth of disputes and of dispute resolution procedures.

Luxembourg has the largest investment fund industry in Europe, with net assets under supervision standing around EUR 6,000 billion. It is also home to several international groups’ headquarters and to financial holdings, intermediate subsidiaries and *ad hoc* vehicles, double luxcos, assetcos and holdcos.

This arises as a result, in particular, of state-of-the-art laws and regulations for investment funds and efficient tax legislation. This is also allowed by a flexible but predictable company law, tried and tested for more than a century. It is also encouraged by a marble-solid protection of financial collateral arrangements, and a smart and adapted securitisation framework, amongst other factors. It also hosts several European Union institutions, including not only financial institutions such as the European Investment Bank and the European Investment Fund, but also the Court of Justice of the EU.

All this creates an ecosystem of credit institutions, financial services providers, investor services, accountants and auditors, fiduciaries, fund managers and advisors, which form contractual and business relations and hence, encounter problems, dissent and disputes.

SHAREHOLDER DISPUTES

The presence in the Grand-Duchy of numerous holding companies, owning directly or indirectly physical or financial assets, inevitably generates a volume of shareholder disputes. These typically arise when shareholders try to challenge management decisions, wider orientations or the distribution policy, or to take over management of the company in which they hold shares.

Substantially, the shareholders will try to rely on the general rules of the Luxembourg law dated 10 August 1915 on commercial companies as amended, which provides rules on the convening of meetings and on the formal rules of deliberations. Often, the unsatisfied shareholder will also appeal to case law concepts such as the abuse of rights, be it abuse of majority, of minority or of equality. Another substantial source of corporate governance rules will be found in the articles of association of the relevant companies or in confidential contracts entered into between the shareholders ("*pactes d'associés*").

This often takes the form of litigation before the District Court of Luxembourg (*Tribunal d'arrondissement de et à Luxembourg*) sitting in commercial matters, But not exclusively so, as mediation processes are starting to appear in Luxembourg legal practice, and the development of arbitration seems to be a slow but irresistible trend.

POST M&A DISPUTES

The presence of holding companies and investment funds generates a volume of mergers and acquisitions (M&A) of Luxembourg vehicles. This automatically brings about disputes, which are better described by referring to the causes thereof – i.e. by mentioning the main documents and stipulations that parties usually invoke.

M&A transactions involve, in the simplest cases, documents such as non-disclosure agreements, term sheets and due diligence reports, share purchase agreements, guarantee agreements (embedded or standalone), shareholder agreements, loan agreements, collateral agreements, amended articles of association, joint-venture agreements, disclosure schedules, intragroup receivables transfers or pledges.

Some provisions of these agreements are 'usual suspects', which typically generate post-M&A disputes. These include 'conditions precedents' and the dispute then arises from the temptation of one party (generally the buyer) to undermine the deal and get out of it before closing. These involve the representations and warranties given by one party to the other (typically by the seller) and the various covenants. In these cases, disputes are generally of a relatively technical nature and can involve the designation of experts and valuers. Often, disputes arise from contractual provisions relating to purchase price, e.g. price adjustment mechanisms between signing and closing, earn-out mechanisms reflecting the performance during the months following closing or valuation gaps between signing and closing or between closing and time of due diligence.

CORPORATE GOVERNANCE SUMMARY CASES

The position of Luxembourg as a financial centre, home to galaxies of holdings and subsidiaries, also gave birth to a very specific type of judicial activity that keeps Luxembourg judges and lawyers busy: summary cases revolving around the possibility, granted by the aforementioned Luxembourg 1915 companies law, of requesting the suspension of corporate decisions.

This possibility arises as a specific type of summary case (*référé*) under the ordinary provisions of the Luxembourg New Code of Civil Procedure governing summary actions, but being repeated and

emphasised by article 100-22(3) of the companies law, which ascribes to it certain specific additional conditions. The purpose of such cases, which are heard by the judge presiding in the competent district court with a certain degree of urgency, is to suspend temporarily the enforcement of resolutions taken by an organ of a company. This allows the temporary neutralisation of a decision which is obviously flawed, pending the ruling of an annulment case on the merits, which generally takes much longer. It is worth noting that the Luxembourg case law has accepted the extension of the scope of these summary cases: initially restricted to resolutions of shareholders, Luxembourg judges also accept such suspension, on the same basis and along the same procedure, of decisions from the management bodies (board, managers, directors, general partners).

In some instances, the same conflicts lead the disagreeing party to seek, rather than the suspension of decisions, the appointment of a temporary judicial receiver (*administrateur provisoire*).

In Luxembourg, such cases have gained a very substantial importance in practice, because they represent the opening of hostilities, the first step of most disputes between investors, companies, management, lenders, holders of collateral or even third parties. This is not only because of the number of holding and subsidiaries, but also because these holding companies have an EU-wide impact resulting from the fact that they hold entire groups and asset portfolios. Indeed, a high proportion of international financial, commercial and industrial disputes will involve at some point a dispute over the resolutions of a Luxembourg entity.

ENFORCEMENT OF COLLATERAL

A key element of the attractiveness of Luxembourg as a financial centre lies in the quality and creditor-friendly law on financial collateral arrangements, enacted in 2005. This law and the application that Luxembourg courts have consistently and wisely made of it, has contributed to a recognised regime whereby a creditor holding a Luxembourg pledge, for instance, benefits from both safety and flexibility. The flexibility comes from the options offered to the parties to such an arrangement, to organise in the desired way the utilisation rights of the pledged assets before and after a default, as well as the enforcement process and timeline. The safety comes from the legally created and judicially protected impossibility of preventing the enforcement of such collateral in all cases except for proven fraud by the creditor. It also lies in their absolute opposability to national and foreign insolvency receivers, while the right of the secured creditor to ‘jump the queue’ is expressly entrenched in the insolvency and international provisions of the law.

The scope of the collateral that may be granted under this regime is wide, and consequently encompasses all the financial assets that populate the Luxembourg financial ecosystem: shares, debt securities, receivables, bank accounts, investment funds units and limited partners’ commitments, and so on.

This entails a number of disputes, revolving around the validity, scope and perfection of the collateral arrangements, their conditions of enforcement, the consequences thereof, the valuation of pledged assets, amongst others. An important volume of court cases is thus produced by these collateral arrangements, both before substance courts (*juges du fond*) and summary judges (*référé*).

ENFORCEMENT OF FOREIGN DECISIONS

The presence of holding companies, investment funds and the relevant service providers also generates an important volume of enforcement procedures for foreign decisions, from either courts or arbitral tribunals. For the latter, it can be either fully fledged decisions or ‘awards’, but also simple orders or temporary decisions. Luxembourg being a member state of the EU, the enforcement of court decisions and arbitral awards will differ based on the jurisdiction where the court or tribunal is

located. For arbitral awards, this generally entails a swift *ex parte* procedure before the judge presiding in the district court. However, if the enforcement is refused, the judge must give reasons for refusal, which may be appealed.

FUNDS AND INVESTORS' DISPUTES

Luxembourg hosts a galaxy of investment funds, which triggers unavoidable disputes. These disputes can be related to the relations between the funds and their investors, or between the funds' management and service providers (Alternative Investment Fund Managers or 'AIFM', for example), to the financial results or to the level of information granted to the investors, or even sometimes to the organisation of the meetings of unitholders. It is also worth noting that certain investment promises or formal limited partner commitments can be disputed and lead to enforcement and, eventually, judicial action.

INSOLVENCY AND REORGANISATIONS

The same causes lead to a large number of traditional insolvency cases, where a creditor can file in the district court to adjudicate that its debtor is insolvent and must be liquidated. This is facilitated by a special rule under article 109 of the Commercial Code (*Code de commerce*) under which a duly sent invoice which is accepted or which is not challenged in time or with substance constitutes evidence of a claim. This rule is provided by the Commercial Code for sales contracts, and partially extended by case law to other types of commercial and financial contracts. The number of such cases has traditionally been high because Luxembourg law did not offer any alternative creditor processes against a failing debtor.

As of 7 August 2023, Luxembourg has introduced a new legal framework that allows debtors — and, in certain circumstances, creditors — to apply for judicial reorganisation. This mechanism enables the preparation of an amicable agreement or a reorganisation plan between the debtor and its creditors, under judicial supervision. Designed as an alternative to bankruptcy, the reform has attracted significant interest from both the commercial and financial sectors.

SPECIFIC DISPUTES UNDER FINANCIAL SERVICES CONTRACTS

Unsurprisingly, the broad financial sector generates a substantial volume of disputes relating to financial services agreements. These cannot be listed, as each financial service is rendered under a specific agreement, which can degenerate in disputes.

More specifically, the investment fund sector drives disputes on AIFM agreements, custody agreements and investment adviser agreements. The banking, capital markets and financing activities typically give rise to disputes around calculation of agent services, security agent services and paying agent services. Typical disputes will revolve around the calculation and payment of fees, or the cause and process for termination by a party.

IF YOU WANT PEACE, PREPARE FOR LITIGATION

Luxembourg is no different from other jurisdictions: traditional litigation before courts is the ultimate recourse when a dispute arises, and is often used as a threat. But in reality, it is not the only dispute resolution method.

First and most obviously, parties to a dispute may discuss, with or without lawyers, and reach a settlement. The Luxembourg Civil Code provides a well-established regime where a settlement agreement, if validly entered into in written form, has the same value as a final court decision on the

matters contained therein (article 2052).

Second, mediation is growing in popularity as a method for the resolution of disputes. Even though the financial sector is not necessarily the sector of choice for mediation, this method could be used more often. The Luxembourg New Code of Civil Procedure provides a precise and useful regime for mediation, whereby a mediation may be initiated by the parties, proposed by the judge or ordered by a judge at the request of the parties (article 1251-2). The know-how and professionalism of the Luxembourg financial players can make mediation a particularly efficient tool that has received increased scrutiny over the past years.

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