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ACQUISITION FINANCE 2023

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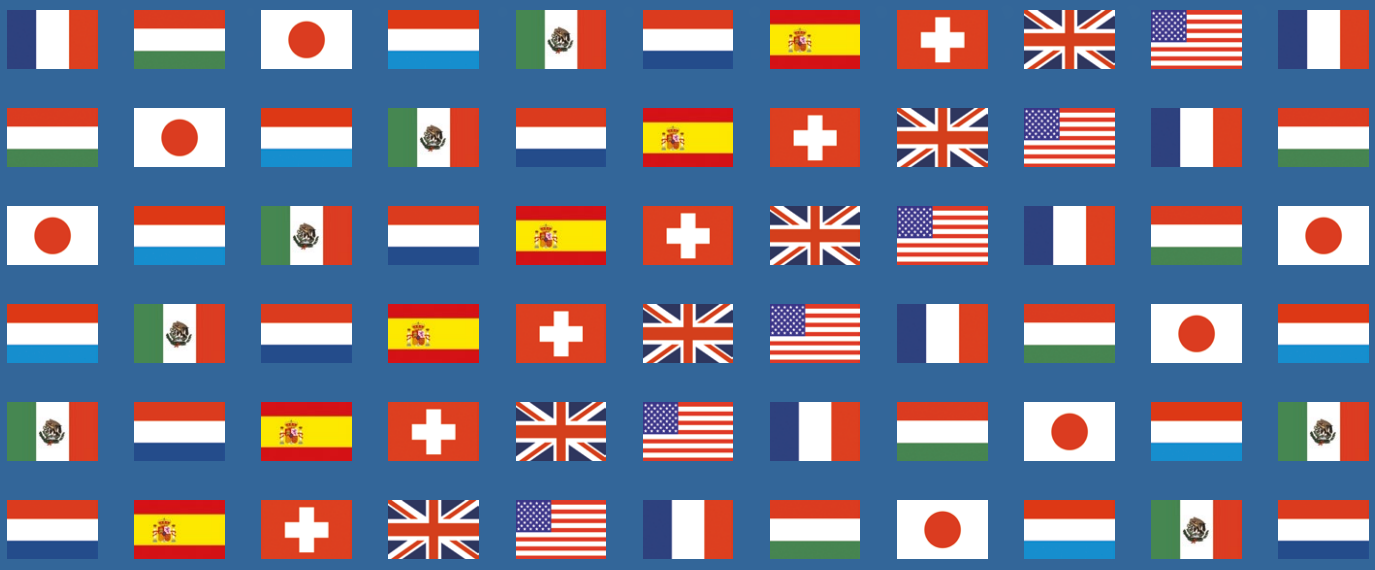

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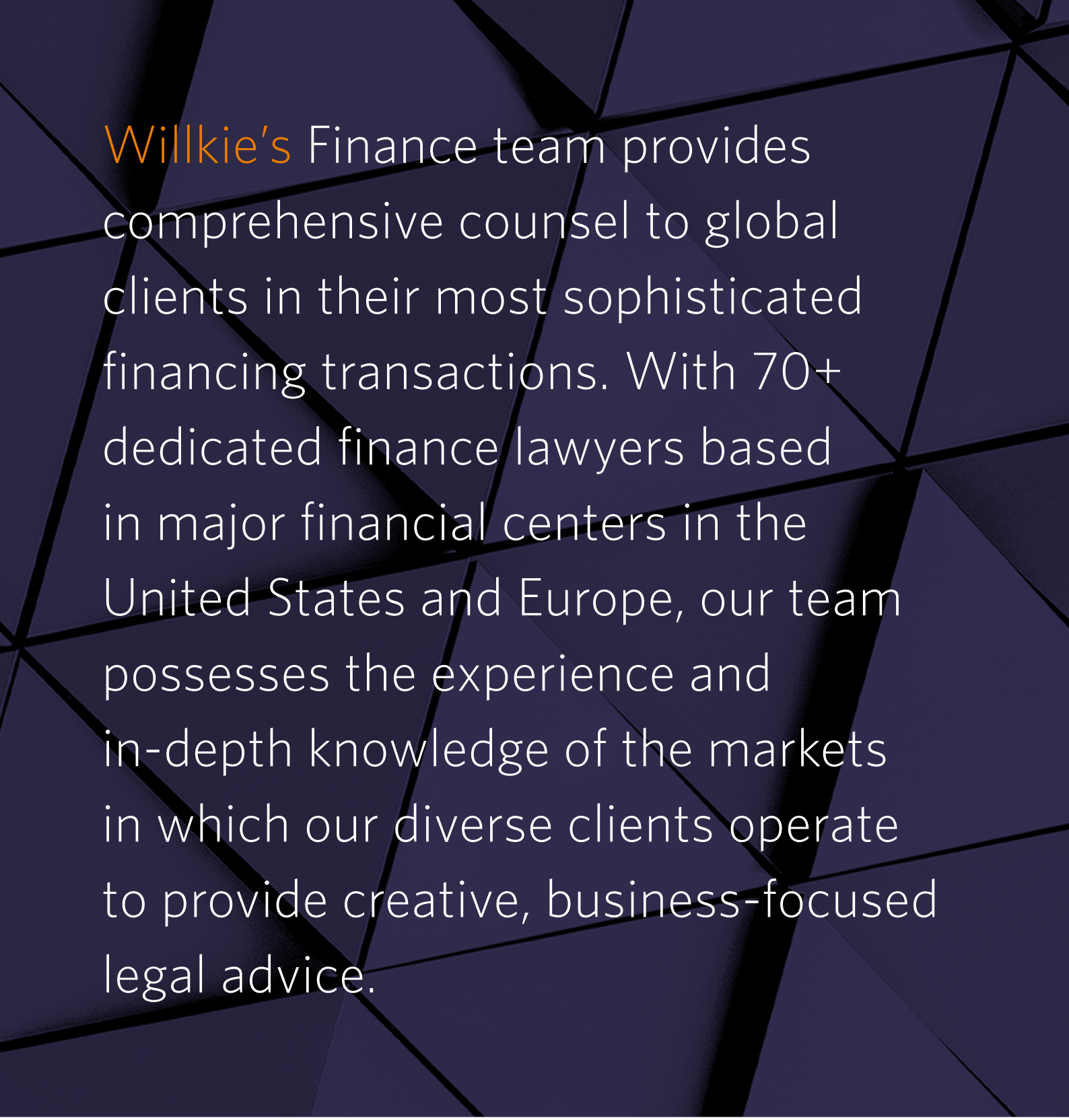

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France

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The acquisition and finance documentation is usually governed by French law, especially if the target company is a French entity and has its main assets in France. However, in cross-border transactions with multiple players located in different jurisdictions, it is possible to choose another law such as English or New York law to govern the finance documentation, especially if an international syndication is being sought.

Any security interest created on rights governed by French law or assets located in France will need to be governed by French law. For personal guarantees, the parties may choose either French law or the law governing the other finance documents. If the acquisition transaction involves the issuance of equity or equity-linked instruments by a French company, those instruments would generally be governed by French law, as the law of incorporation of the issuer.

The choice of a foreign law to govern the transaction documents will generally be recognised by French courts based on Regulation (EC) No. 593/2008 (Rome I) on the law applicable to contractual obligations. However, specific French law mandatory provisions will need to be considered when taking security over rights or assets in France.

Judgments obtained in any European Union member state will generally be recognised and enforced by French courts on the basis of the Recast Brussels Regulation ((EU) No. 1215/2012) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters provided that the exclusive jurisdiction rules established therein are complied with.

Judgments from the courts of Iceland, Norway and Switzerland are generally recognised and enforced by French courts based on the Lugano Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters. To date, we understand the United Kingdom's application to join the Lugano Convention has not been accepted by the EU.

As to judgments from English courts after BREXIT, the United Kingdom (since 1 January 2021) and the European Union are both parties to The Hague Convention on Choice of Court Agreements, which gives effect to the choice-of-court agreements and recognition of resulting judgments between contracting states. Thus, French courts would recognise English judgments rendered in respect of an agreement concluded after 1 January 2021 provided, however, that such agreement contains a two-way exclusive jurisdiction clause.

For any other foreign judgment not falling into one of the above categories, an inter partes action for recognition and enforcement (*exequatur*) would need to be conducted before a French court. In such an action, the French court would not re-open the merits of the case but could refuse enforcement on specific grounds.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Despite a general principle of freedom of financial dealings, foreign investment may be subject to the requirement to obtain prior authorisation from the French Minister of the Economy if three cumulative criteria are met.

These criteria relate to the foreign origin of the investor, the nature of the planned investment and the activities carried out by the target company.

Three types of investor are subject to foreign investment control: (1) foreign nationals or French nationals not domiciled in France; (2) entities governed by foreign law (a 'Foreign Entity'); and (3) entities governed by French law (a 'French Entity') and controlled by individuals or entities falling into categories (1) or (2).

These investors are subject to foreign investment control if any of the following types of transactions are considered:

- acquiring a controlling stake in a French Entity;
- acquiring all or part of a branch of a French Entity; or
- crossing directly or indirectly, individually or as a group, the 25 per cent of the voting rights threshold of a French Entity. For equity investments in companies whose shares are listed on a regulated market, the threshold had been temporarily reduced to 10 per cent because of the covid-19 pandemic. This temporary measure has been extended until 31 December 2023 in the economic context linked to the energy crisis. The modalities of the measure to lower the threshold for control remain unchanged for 2023: (1) It does not apply to investors from an EU/EEA country; (2) it only applies to investments in companies listed on a regulated market; and (3) the control is carried out according to an accelerated procedure: the Foreign Entity crossing the threshold of 10 per cent of the voting rights shall notify the *Direction Générale du Trésor*. The Minister of the Economy, Finance, Industrial and Digital Sovereignty has 10 days to decide whether the transaction should be subject to further examination, on the basis of a complete application for authorisation.

Finally, only qualified transactions in certain types of activities are subject to foreign investment control:

- activities that, by nature, affect national defence, the exercise of public authority, public order or national security (for example, weaponry, defence against pathogenic or toxic agents, intercepting correspondence or collecting data);
- activities relating to infrastructure, goods or services that are essential to the national interest (in particular the supply of water and energy, the operation of transport or

telecommunications networks, public health, food safety or the media). A case by case analysis is required to verify whether a company falls into this category; and

- research and development activities in certain critical technologies (such as cybersecurity, artificial intelligence, quantum technologies, biotechnologies or technologies involved in the production of renewable energy) or dual-use technologies (civil and military) in connection with the aforementioned sectors.

There are two observations to be drawn from these criteria. The first is that a transaction may be subject to scrutiny by the French authorities even if it is not directly targeted at France: for example, the acquisition by a Chinese investor of an American group, one of whose subsidiaries carries out a protected activity in France. The second is that where the target company carries out a protected activity, even if it is not its main activity, this will suffice to subject the transaction to the prior approval requirement.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Acquisitions in France are usually financed by a combination of equity and debt. Depending on the leverage of the transaction, the acquisition debt often consists of senior debt only, but may, in more complex or leveraged financings, include, inter alia, mezzanine debt (including cash interest, payment-in-kind components or a combination of both), first and second lien debt and junior debt. The senior debt is usually structured in the form of a term loan arranged by the banks, whereas the mezzanine debt is usually structured in the form of bonds with attached warrants offered by private debt lenders. It is important to note that the role of private debt lenders has significantly increased in the French acquisition debt market over recent years. They structure and provide unitranche debt (being a mix in one single instrument of senior and mezzanine debt and offering a blended margin to the borrower) to overcome complex senior or mezzanine intercreditor issues raised by the implementation of the 'double Luxco structure' in French acquisition finance transactions. Unitranche is usually provided by one single lender (as opposed to a syndicate of lenders in a senior credit facility) making negotiations, consents and waivers more straightforward for the borrower. To comply with French banking monopoly rules, private debt lending was initially structured in the form of bonds but following a recent change in EU and French legislation, some French debt funds and European alternative investment funds (AIF) are now entitled to arrange and fund term loans granted to French borrowers. The junior debt is usually structured in the form of shareholder loans or bonds convertible or redeemable into shares, and is contractually subordinated to the senior and mezzanine debt. For large cap transactions, super-senior revolving credit facility structures ranking in priority to the Term Loan B on enforcement are also available.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

For public takeovers, the prior availability of the financing is a mandatory condition to the launch of the public tender offer. The bidder must appoint a presenting and guaranteeing bank that will file the public tender offer with the French Financial Markets Authority (AMF), guarantee its terms and undertake, as an independent obligation, to settle the purchase price of any securities tendered as part of the bidder's public offer. Before granting its guarantee and agreeing to file the offer, the presenting bank would usually require either a letter of credit or cash collateral in its favour covering at least 100 per cent of the amount of the public tender offer. The presenting bank may also be party to the acquisition facility agreement and be entitled thereunder to request utilisations on behalf of the bidder during a 'certain funds' period to settle the payment of the tendered securities.

For private transactions, there are no specific French law requirements to provide certainty of funds to the seller. Usually, a letter of intent from a lender confirming its willingness to provide the financing to the purchaser would be sufficient for the seller. From time to time, in the context of a bid process, a seller might require a binding financing. This requirement can be addressed by a certain funds commitment of the lender in the financing documentation, or even, in some circumstances, by a bridge loan to be refinanced when the parties agree a long form of the acquisition finance documentation. A financing based on a binding term sheet is not an option.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

The proceeds of the financing must be used in accordance with the agreed contractual purpose. The documentation usually contains strict rules regarding the purpose and use of the proceeds. In general, the relevant proceeds must be applied to finance the purchase price, fees and other related acquisition costs, to refinance the target's existing indebtedness and to finance its working capital needs. A violation of this provision usually constitutes a breach of contract.

In addition, utilisations made in breach of any international sanctions, anti-bribery, anti-money laundering or anti-terrorist rules applicable in France would result either in an event of default for breach of law, or, if stipulated by the parties, an obligation to prepay the whole financing.

In addition, under French law financial assistance rules, neither the French target company nor its subsidiaries may provide any kind of financial support or assistance to the company purchasing it. As a result of such prohibition, any financing made available to the target companies may not be upstreamed to finance or refinance the acquisition debt. The use of proceeds must always comply with the borrower's corporate interest.

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Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

French banking monopoly rules as set out in article L. 511-5 et seq of the French Monetary and Financial Code prohibit institutions other than French licensed or European licensed credit institutions from carrying out credit operations in France. As a result, only (1) credit institutions licensed in France (ie, either French institutions or non–EU institutions whose branch in France is licensed by the French banking authorities) and institutions registered in an EU member state (or in another member state of the European Economic Area) that benefit from the 'single passporting' rules under Directive 2006/48/EC (formerly Directive 2000/12/EC); and (2) non-credit institutions that do not carry out credit operations on a habitual basis, may lend money to a borrower located in France. More recently, certain private debt funds incorporated in the form of French undertakings for the collective investment in transferable securities or European AIFs have been added to the list of authorised entities entitled to carry out credit operations in France.

French banking monopoly rules have territorial application. According to article 113-2 al.2 of the French Criminal Code, a criminal offence will be deemed to have been committed on French territory if one of its factual components was carried out in France. However, in the absence of statutory provisions and decisive French case law, the question of whether a particular transaction is carried out in or outside France is subject to legal uncertainty and rather complex, as it is heavily reliant on factual matters requiring a case-by-case analysis. The French banking authorities have informally expressed the view (which is shared by most French academics and legal practitioners) that, in determining where a credit transaction has taken place, in the absence of fraud, the most relevant test is where the funds are actually made available to the borrower, where the loan is to be reimbursed and where the proceeds are used.

There are certain exemptions to the French banking monopoly requirements, among which is the recent exception to favour the syndication of existing funded facilities (secondary trades) to non-licensed foreign institutions such as debt funds or securitisation vehicles.

Any breach of the French banking monopoly rules may result in up to three years imprisonment for the directors, managers and other responsible individuals within the entity that breaches the banking monopoly and fines of up to €1,875,000 for each infraction if the offender is a corporate entity.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

In general, France does not impose withholding tax on interest paid to non-residents.

As an exception, interest payments made in a non-cooperative state or territory (NCST) are subject to a 75 per cent withholding tax, regardless of the tax residence or the registered

office of the recipient, and unless the debtor demonstrates that the main purpose and effect of the transactions to which these payments relate was not that of allowing payments to be made in an NCST.

The list of NCSTs is regularly updated by way of official decree. As at 2 March 2022, this list included: American Samoa, Anguilla, the British Virgin Islands, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, the US Virgin Islands and Vanuatu.

The debtor or the paying institution must deduct the withholding from the interest amount and pay it to the French public treasury. The withholding cannot be borne by the debtor, meaning that it must be assessed on the gross amount of interest.

Facility agreements generally contain a gross-up clause according to which, in the event that interest payments become subject to a withholding after the execution of the agreement (eg, the state in which payment is made is added to the NCSTs list), the borrower undertakes to increase the amount of its payments so that the lender receives the amount it would have received in the absence of such withholding.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Restrictions on usury interest do not apply to loans granted to individuals acting for their professional needs or to legal entities engaged in any industrial, commercial, artisanal, agricultural or non-commercial professional activity.

It is worth noting that French law prohibits the capitalisation of interest except in the case of interest accrued for a period exceeding one year. This prohibition may raise issues in debt instruments with payment-in-kind features providing for capitalisation of interest every six months.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

The finance documentation typically includes indemnities for, inter alia, currency conversion, late payment, loss incurred in connection with the financing, costs in connection with amendments and waivers, costs in connection with perfecting, enforcing or preserving security interests and all the other usual market standard clauses such as increased costs, break costs and tax indemnities.

Due diligence reports on the target group and its assets prepared for the purchaser are usually disclosed to the finance parties. If such disclosure is made with a reliance letter, the finance parties may also directly sue the purchasers' advisers if their reports are proven incorrect, incomplete or misleading.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

The finance documentation typically provides that the rights and obligations of a lender may not be assigned or transferred to a third party without the prior consent of the borrower (such consent not to be unreasonably withheld or delayed) or at least without it being consulted in advance, unless such assignment is made to another existing lender or affiliate or a related fund or made while an event of default has occurred and is continuing. In order to facilitate the syndication of the financing, parties often agree upon an approved list of potential lenders to whom the transfer may be freely made at any time.

Of course, all usual provisions enabling a lender to refinance or grant security on its participation are customary and would not require borrower consent.

Any new lender purchasing a participation or entering into a sub-participation in a financing made available to a French borrower must ensure that it complies with the French banking monopoly rules, especially if the participation being purchased includes a commitment to lend that is still available to the borrower. For the transfer of participations in a funded term loan, the conditions to their transfer to foreign entities have been recently relaxed by article L.511-6 4° of the French Monetary and Financial Code.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Provided the appointed agent receives no cash deposits and provides no payment services (these are both regulated activities) acting as an administrative or collateral agent is not per se a regulated activity. This activity is generally exercised by licensed credit institutions but can sometimes be delegated to non-financial institutions, especially if the financing is structured in the form of bonds, where the appointment of a bondholders' representative is mandatory for the purpose of taking security.

French law does not recognise the concept of a trustee but did introduce in 2007 the concept of *fiduciaire*, which is very similar to the role of a trustee and remains a regulated activity.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Debt buy-backs are not prohibited under French law but the finance documentation usually restricts or prohibits borrowers and their sponsors from carrying them out. If permitted, the voting rights of the new lender are usually disenfranchised and are not taken into account in the lenders' decision-making process. If the debt is repurchased by the borrower, it is automatically extinguished by operation of the doctrine of *confusion* as the debtor and creditor would be the same entity. On the other hand, if the debt is repurchased by any other affiliated entity, it becomes a related party debt.

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Separate rules regarding equality of bondholder treatement would apply to certain types of more widely held bond issues.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Outside of the context of certain types of bond issue, there are no general rules under French law restricting or prohibiting how majority, or, unanimous consents are solicited in a buy-back for the purposes of amending the covenants in the existing documentation. The agreed contractual rules for amendments and waivers would apply.

It is, however, a criminal offence for a bondholder to obtain or be promised to obtain, or for a person to grant or promise to grant, advantages in exchange for voting in a particular way or refraining from voting at a bondholders' general meeting.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

Down-stream guarantees are usually not restricted or limited as it is assumed by French case law that it is in the best corporate interest of the parent company to grant credit support to its subsidiary.

For up- and cross-stream guarantees, on the other hand, several cumulative factual conditions, as set out by French case law, must be complied with to avoid any potential misuse of the corporate assets or credit of the guarantors, which is a criminal offence for the individual directors of the guarantor:

- the guarantor and the guaranteed debtor must belong to the same group and that group must be a coherent economic entity with real commercial and economic ties;
- there must be a common interest (from an economic, employment or financial point of view) for the group as a whole (and not only for the parent company);
- there must be adequate consideration (not necessarily monetary) for the subsidiary entering into the guarantee; and
- most significantly, its commitment under the guarantee must not exceed its maximum financial capabilities.

All these criteria must be assessed by the directors of the guarantor at the time the guarantee is granted. Consequently, it is recommended that appropriate limitation language be included in upstream or crosstream guarantees to ensure, inter alia, that the maximum financial capabilities of the guarantor will not be exceeded and to exclude from the scope

of the guarantee any acquisition debt to comply with the French law financial assistance prohibition.

Up-stream or cross-stream guarantees granted in violation of the above-mentioned criteria would nonetheless remain valid but could result in a civil and criminal liability for the directors of the relevant guarantor.

French law does not restrict or impose limitations on the granting of guarantees by foreign entities to their French subsidiaries or parents, but there might be consequences as regards the deductibility of interest payments for tax purposes.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

Any French company having share capital, such as a *société anonyme*, a *société par actions simplifiée* or a *société en commandite par actions*, is prohibited from financing or granting any kind of support for the acquisition of, its own shares or the shares of its direct or indirect holding company, in particular by granting guarantees or security or providing up-stream loans to its purchaser. As a result of this financial assistance prohibition, a French target company can neither guarantee nor grant security in respect of its acquisition debt and it is required to exclude such debt from the scope of the guaranteed obligations. It is common practice to apply these rules to the direct and indirect French subsidiaries of the target company. A quick merger between the purchaser and the target company must also be considered very carefully, especially if planned before the acquisition.

There is no whitewash procedure or equivalent in France.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

The French security package mostly depends on the borrower's available rights and assets, the financing structure, the ability of the target group companies to grant up- and cross-stream guarantees and the ability of the lenders to push down refinancing and revolving and/or capex debt to the level of the target group.

The concept of floating and fixed charges does not exist under French law. Each security will need to be determined on a case-by-case basis depending on the assets and rights over which it will be created and the quality of its beneficiaries (eg, bank and credit institutions may benefit from collateral (such as the Dailly assignment) that is not available for private debt lenders or bondholders). The usual security package would include, inter alia, pledges over the target shares and, if agreed by the sponsor, the borrower's shares (to be entered into in the form of a securities account pledge agreement if the pledged shares are issued by a *société anonyme* or a *société par actions simplifiée*), the bank accounts, the 'ongoing

concern' of the operating companies and a pledge or assignment by way of security of intra-group or commercial receivables. For costs reasons, security is usually not taken on real estate property.

When structuring and agreeing the French security package, creditors should bear in mind that the security package must not be disproportionate. If creditors have taken disproportionate collateral to support their financing, they can be held liable, and the relevant collateral can be cancelled or reduced by a French court.

To mitigate any hardening period nullification risk on the French security package, it is also market practice to grant all the French collateral on the completion date of the acquisition and not subsequently on the basis of agreed security principles as is often the case in cross-border acquisition finance transactions.

Since 1 January 2022 and the coming into effect of the French law security reform enacted by Ordinance No. 2021-1192 of 15 September 2021, any creditor that is not eligible for the Dailly assignment of receivables may nonetheless benefit from the new assignment of receivables by way of security introduced in the French Civil Code that provides for a legal regime very similar to the Dailly assignment receivables regime, except that the assignee does not need to be a regulated entity (ie, a credit institution, a debt fund or a securitisation vehicle).

The legal regime of the cash collateral has been clarifed and strengthened with the creation of a new cash assignment by way of security.

It is also worth noting that in the context of this security reform, the legal regime of the 'third-party security interests' (ie, security interests granted by a third party on its assets or rights to secure the obligations of another obligor) has been significantly amended to strengthen the information rights of the security providers and to extend the duties of the secured creditors as from 1 January 2022 that have to apply a great number of protective provisions set out for personal guarantees. Professional lenders will have to comply with: (1) annual information duty to inform their security providers on the amount of their remaining secured obligations at the end of each financial year on or before 31 March of the next calendar year; and (2) a creditor's obligation to warn the security providers on the risk undertaken by granting their security.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

As general principle, a security interest must be entered into in writing, and it becomes valid and enforceable between the parties on its signing date. Unless the security interest is taken over real estate, there is no particular requirement as to its form of execution, it being specified that as from 1 January 2022, any security interest or guarantee may be executed in electronic format.

Depending on the type of security interest, it becomes enforceable against third parties on the signing date, on the date it is registered with the competent registry or on the date the relevant third party is notified.

For example, a securities account pledge agreement is validly created by executing a statement of pledge, normally appended to the pledge agreement. The signing of this statement of pledge is the sole requirement for legally creating the pledge. It becomes enforceable between the parties and against third parties on such date; it being specified that the securities account holder will need to register such pledge in its books and to issue a pledge certificate.

A pledge over receivables is validly created between the parties and is enforceable against third parties (other than the debtor of the pledged receivables) upon the signing of the pledge agreement. To become enforceable against the debtor, the debtor must either be notified of the pledge or become a party to it. In the absence of such perfection formalities, the debtor may continue to validly discharge its payment obligations with the pledgor.

A non-possessory pledge over movable assets must be fled with the competent commercial registry in order to become effective against third parties whereas a possessory pledge over movable assets will become effective upon dispossession of the pledged assets in favour of the secured creditor or an appointed third-party holder.

A mortgage over real estate must be executed in the form of a notarial deed before a French public notary and registered with the Land Registry. It becomes enforceable against third parties on the date of its registration after the payment of various costs including real estate registration duties.

A pledge over going concern needs to be registered with the client of the relevant commercial and companies registry.

Finally, the new cash assignment by way of security is validly created between the parties on the signing date and is enforceable against third parties from the date of delivery of the sum of cash to the assignee, without the need for further formalities.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Security interests filed with a French public registry need to be renewed in certain circumstances. For example, a pledge over ongoing concern is valid for a period of 10 years and must be renewed before the expiry of such period if the obligations it secures have not been discharged or released by that time. The registration of a non-possessory pledge over movable assets is valid for a period of five years and should also be renewed before its term. As part of the security legal reform, a decree establishing a new general French public registry was adopted on 1 January 2023.

For all other security interests that are not subject to filing perfection formalities with a public registry, the general rule is that they remain attached to the obligations they are

securing until such obligations have been extinguished, discharged or otherwise released by the secured creditor.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

This depends on the corporate form of the French guarantor or security provider.

For the two main types of companies (*société anonyme* and *société par actions simplifiée*), the rules are as follows:

- In a French *société anonyme,* the granting of a guarantee or security is subject to the prior approval of its board of directors or supervisory board and failure to obtain such prior approval will result in the guarantee or security not being binding and enforceable against the company. The decision must specify the amount of the collateral and can only authorise the general manager or the deputy general manager to execute the collateral on behalf of the company. The board of directors may also grant an annual and global authorisation for guarantees made for the benefit of controlled companies within the meaning of article L. 233-16 II of the French Commercial Code. In addition, if the transaction involves group companies with common directors, managers or shareholders, it is also often necessary to approve in advance the transaction documents to which they will be a party as interested related-party transactions.
- In a French *société par actions simplifiée*, the president (the company's legal representative) is in principle entitled to grant a security interest unless provided otherwise in the by-laws or the corporate decisions relating to his or her appointment. However, the prior approval of the shareholders is generally required if the enforcement of the security may lead to the transfer of the majority of the company's assets.

Consultation with the works council (in companies with more than 50 employees) is mandatory for any important decision pertaining to the organisation or the management, or where the decision may have concrete consequences for the employees and their working conditions.

In principle, the granting of a security interest would not qualify as a decision requiring the works council to be consulted per se. However, in instances where the granting of a pledge over a portion of the shares of the company may result in a change of control (if the loan is not repaid and the collateral enforced), there is an argument for consulting the works council before the collateral is granted. In the context of LBO transactions, the works council of the target company will be consulted in any event, and information on the financing structure and security package will be shared with the works council during that process.

In any case, a negative opinion from the works council would not prevent the company from granting the collateral. On the other hand, not consulting it could lead to criminal sanctions against the company and its legal representative (should a court decision rule that the granting of the collateral had a significant impact on the company and on its employees).

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Both options are available: security can be granted (1) directly for the benefit of all the lenders as represented by a security agent appointed by them to create, perfect and enforce the security for their account and on their behalf, or (2) for the sole benefit of a security agent acting in its own name but for the benefit of the lenders pursuant to the recently-introduced security agent regime set out in article L. 2488-6 of the French Civil Code. Since this security agent regime is rather new and raises accounting and booking concerns for French banks wishing to use it, the preferred option is still to rely on security agency provisions, which would be included in the facility agreement or in the intercreditor agreement.

Note, however, that if the financing is structured in the form of a bond issuance governed by French law, the bondholders must be grouped in a *Masse* represented by a bondholders' representative appointed by the bondholders pursuant to article L. 228-47 and seq of the French Monetary and Financial Code. The appointment of the bondholders' representative is mandatory for the purpose of receiving the benefit of the security as the *Masse* does not have legal personality and may not itself benefit from any security.

In cross-border finance transactions governed by a foreign law, the use of a parallel debt obligation to take certain French law security in favour of a sole security agent has been recognised by the French supreme court.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

There is no specific protection afforded by French law. The usual way to address this risk is to grant a conditional release that becomes effective upon confirmation by the security agent that the secured obligations have been repaid or discharged. However, if the payment received is later challenged by a judicial administrator in the context of insolvency proceedings, it is very unlikely that the existing released security could be reinstated.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

French law contains specific provisions (*action paulienne*) dealing with fraudulent transfer both in and outside insolvency proceedings. These provisions aim at offering creditors protection against a decrease in their means of recovery.

Pursuant to these rules, legal acts (including, notably, agreements through which the debtor guarantees the performance of the obligations of a third party or provides security to a third party) prejudicing a creditor in its means of recovery can be challenged in or outside insolvency proceedings and be declared unenforceable against all creditors or a particular

creditor (depending on whether the *action paulienne* is lodged by a court-appointed officer in the context of insolvency proceedings of the debtor or an individual creditor).

The court will grant the action if it is established that (1) the debtor performed the challenged act without an obligation to do so; (2) the creditor concerned (or, in case of insolvency proceedings of the debtor, any creditor) was prejudiced in its means of recovery as a consequence of the act; (3) at the time the act was performed, both the debtor and the counterparty to the contested act knew or should have known that one or more of the debtor's creditors (whether actual or future) would be prejudiced in their means of recovery (it being specified that such knowledge is not required when the challenged act was entered into for no consideration).

In addition, French law provides for clawback provisions applicable only in the context of rehabilitation or liquidation proceedings.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

Market practice is to fund the acquisition following signing of long-form versions of the finance documents (including all security documents) which in turn have been based on a negotiated short-form commitment letter and term sheet. Funding is not done solely on the basis of commitment documents, but parties may agree on a short-form bridge loan (including security): this would be refinanced when the long-form version of the finance documentation is agreed among the parties.

The standard Loan Market Association finance documentation for leverage financing or a Term Loan B facility is usually used as the basis for discussions in large cap transactions, whereas there is no available standard for small and mid-cap transactions and the documentation may vary significantly from one lender to another.

If the acquisition debt is arranged by a private debt fund, the documentation is often structured in the form of a subscription agreement with the terms and conditions of the bonds appended to it.

French market practice is for the finance documentation to be prepared by the lender's counsel, but in a sponsor-backed transaction, the sponsor may negotiate the right for its legal advisers to prepare the first drafts of the finance documentation.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

This depends on the factual circumstances of the transaction, the sector in question, the creditworthiness of the borrower (or its sponsor) and the parties involved. For acquisition debt arranged by banks and credit institutions, all the above options are usually available; though the trend in small and mid-cap transactions is rather to arrange club deals with a limited number of lenders appointed at the outset of the transaction. For unitranche debt arranged by private debt funds, the debt is usually underwritten and arranged by one single entity which might distribute it to related funds managed by the same management company. In general, unitranche debt is more expensive than bank debt but offers more flexibility in the covenants for the borrower and can usually be executed more quickly. In addition, unitranche lenders often have a bigger hold appetite than banks, as well as an appetite to fund higher multiples of EBITDA.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The conditions precedent to funding contained in the commitment letter usually include, inter alia, the following:

- the signing of the finance documentation in form and substance satisfactory to the parties based on the agreed term sheet and the satisfaction of all conditions precedent to signing and first utilisation thereunder (no potential event of default or event of default, no misrepresentation, no material adverse effect, the creation and perfection of the agreed security package, final due diligence reports addressed to the finance parties with release or reliance letters, a satisfactory tax and structure memorandum);
- the satisfaction of all conditions precedent under the acquisition documents (works council consultation, anti-trust clearance, if agreed with the purchaser, the absence of material adverse change on the business, operation, management, financial situation or assets of the borrower, the target company and the target group);
- no disruption of the international or domestic capital markets or interbank markets that would likely impair the lender from obtaining its funding for the contemplated financing;
- no insolvency proceedings on the borrower, the target company or the target group; and
- no incomplete, false, incorrect or misleading information provided to the finance parties regarding the transaction.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Market flex provisions are usually included in commitment letters that are not fully underwritten or subject to successful syndication. They are always included in Term Loan B

financings. They generally cover margin, fees and contractual terms. On the other hand, reverse flex provisions for the benefit of the borrowers and aimed at reducing the margin and the fees if the commitments within the syndication process are oversubscribed are rarely seen.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

This kind of feature is not commonly seen in France.

For acquisitions initiated by listed corporates, it happens from time to time that the acquisition is financed by a bridge loan, which is refinanced at a later stage by the issuance of listed securities (bonds, shares or hybrid instruments) depending on the available capital market conditions.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

In arranging its acquisition financing, a lender would usually consider the following key elements in the acquisition agreement:

- the purchase price payment terms and the purchase price formula (being a multiple of the target's EBITDA that may vary from one sector to the other); if any earn-out is payable in the future, it is key to understand how it will be financed by the purchaser;
- the seller's warranties (if any and if so whether they include liability caps and limitations on bringing claims) and how they can be delegated to the lenders to prepay the acquisition debt in whole or part;
- the conditions precedent to the acquisition as set out in the sale and purchase agreement and the ability of the purchaser to walk away from its acquisition if a material adverse change impairing the target company and its business has occurred;
- the potential liabilities and tax issues disclosed in the due diligence reports and the structure memorandum;
- if the target's activity is regulated, how the appropriate licence and authorisations will be maintained after the change of control;
- a long-stop date for the acquisition; and
- if there are any sellers' rights surviving completion of the acquisition.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

For the acquisition of private companies, there is no requirement to make commitment letters or acquisition agreements publicly available. The seller may require a copy of the commitment letters to check that the purchaser will be able to obtain its financing.

Conversely, for the acquisition of a French listed company, the following requirements must be complied with:

- the purchaser must file a tender offer with the Financial Markets Authority (AMF) in accordance with the General Regulations of the AMF in respect of all of the outstanding listed securities granting access to the share capital of the target company;
- the terms and conditions of the public tender offer must be set out in a draft information note and in a deposit letter to be filed with the AMF;
- the terms of the tender offer (timing, purchase price, fairness opinion or squeeze-out option) are made public after being approved by the AMF; and
- the initiator of the tender offer must irrevocably appoint a presenting bank to guarantee the content and irrevocable nature of its undertakings as set out in the draft information note and deposit letter filed with the AMF.

The commitment letter and terms of the financing do not need to be disclosed to the public since the presenting bank gives a direct undertaking to pay for the tendered securities at the end of the tender offer.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Although French insolvency law may now be regarded as more balanced and less debt-or-friendly than it historically was, especially since the entry into force, on 1 October 2021, of a French government's ordinance of 15 September 2021 transposing the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 (the Ordinance No. 2021-1193 of 15 September 2021), French insolvency law provisions can still have a significant impact on the ability of lenders to enforce debt claims and security interests.

There are four main types of insolvency proceedings under French law:

- accelerated safeguard proceedings (which may be opened at the end of conciliation proceedings to allow the imposition of a restructuring plan on dissenting creditors through a cross-class cramdown);

- safeguard proceedings (available to debtors that are not insolvent but experience difficulties they cannot overcome);
- rehabilitation proceedings (that must be mandatorily requested by cash-flow insolvent debtors within a maximum of 45 days); and
- judicial liquidation proceedings (that concern cash-flow insolvent debtors whose recovery is manifestly impossible).

A non-French debtor may apply for the protection of French insolvency proceedings if it can demonstrate that it has its centre of main interest (COMI) in France.

The opening of insolvency proceedings may notably impact the enforceability of a lender's rights against its debtor in that it triggers a general stay of action against the debtor and its assets for all pre-petition claims (ie, debts incurred by the debtor before the judgment opening the insolvency proceedings). Under French insolvency law, the sums due under a loan are considered as pre-petition debts if those sums have been lent prior to the opening of the insolvency proceedings (even if their maturity falls after the opening of the insolvency proceedings).

As from the opening of any safeguard or rehabilitation proceedings, the debtor will be precluded from paying any debt arising before the opening of the proceedings (with a few exceptions), and any pledge enforcement action (eg, by way of private foreclosure) is frozen. Creditors (whether secured or not) are prohibited from pursuing any legal action against the debtor in respect of these debts if such actions aims at obtaining the payment of a sum of money, the termination of a contract with the debtor for non-payment of a sum of money or the enforcement of security over the debtor's assets (including when the security interest granted over the debtor's assets secures a third party's obligations). Contractual events of default triggered by the opening of insolvency proceedings are (although generally provided for in finance documentation) not enforceable under French insolvency law and cannot be relied upon to accelerate the debt. Furthermore, collateral 'top-up' clauses (which, for instance, require a borrower to post additional collateral or provide for the automatic replenishment of a securities account pledge when the value of the collateral falls below a certain threshold) are, subject to limited exceptions, also frozen as from the date of the opening of French insolvency proceedings.

When a debtor is subject to safeguard, rehabilitation or liquidation proceedings, security interests may be cancelled or reduced by the French court if (1) they are disproportionate to the amount of the loan granted and (2) such disproportion has caused damage to the debtor for which the lender is held liable.

Creditors must file a statement of claim within a time limit of two months (four months for creditors residing outside France) from the date when the judgment opening the insolvency proceedings is published. If the claim is secured, the nature and scope of the security interest as well as, if applicable, the indication that it secures a third party's obligations must be mentioned in such statement.

In order to mitigate the detrimental consequences of any stay of action on their security package, lenders generally strive to obtain security interests vesting them with ownership rights on the debtor's assets (eg, by requesting the transfer in *fiducie* of certain assets or rights to an appointed *fiduciaire*) or granting them effective retention rights on the pledged

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assets (eg, by requiring a possessory pledge on movable assets of their debtor). In cross-border transactions with private equity sponsors located in Luxembourg the 'double Luxco structure' is also common. This structure allows creditors to enforce their share security at the level of a Luxembourg law parent company by relying on the more favourable security enforcement regime offered by Luxembourg law.

Debtor-in-possession financing

31 | Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Prior to the entry into force of the Ordinance No. 2021-1193 of 15 September 2021, French law provided for a mechanism through which lenders that provided new money to a debtor subject to pre-insolvency conciliation proceedings that lead to a court-approved conciliation agreement could benefit from the 'new money privilege' in the case of subsequent insolvency proceedings opened against the debtor. Such new money privilege grants the concerned creditors a priority of payment over all pre-petition claims and most post-opening claims in the event of subsequent insolvency proceedings. It also protects them from having their claims benefiting from such privilege being written off or rescheduled without their consent in the context of the adoption of a restructuring plan in safeguard or rehabilitation proceedings (even through a cram-down).

As an incentive for new financings granted to debtors after the opening of insolvency proceedings, Ordinance No. 2021-1193 of 15 September 2021 added to this mechanism a new privilege called the 'post-money privilege'. This new privilege applies to all new cash contributions (except those made through a share capital increase) made (1) during the observation period of insolvency proceedings to ensure the continuity of the debtor's business during the procedure and/or (2) for the implementation of a safeguard or rehabilitation plan.

Like the new money privilege, claims benefiting from the post-money privilege cannot be written-off or rescheduled without their holders' consent in the context of the adoption of a restructuring plan in safeguard or rehabilitation proceedings (even through a cram-down). Such claims will also be subject to a preferential treatment in the context of possible subsequent liquidation proceedings.

Stays and adequate protection against creditors

32 | During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

The judgment opening insolvency proceedings will stay all individual actions and creditor recourse, subject only to very limited exceptions such as enforcement of retention of title clauses, set-off of related claims, and rights of retention attached to certain security interests.

There is no specific protection for existing security interests holders who become subject to superior claims.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

When a debtor is subject to rehabilitation or liquidation proceedings, any transaction (eg, payments under a loan, a sale of assets or the creation of a security interest) entered into during the hardening period can be subject to clawback provisions.

The hardening period runs from the actual date of insolvency of the debtor (defined as the date on which the debtor becomes unable to pay its debts as they fall due with its immediately available assets, taking into account available credit lines, existing debt rescheduling agreements and moratoria) up until the date on which insolvency proceedings are opened by a court. If the court finds out that the date of insolvency declared by the debtor is not its actual date of insolvency, it may move back the recorded date of insolvency to the actual date of insolvency, by 18 months at most.

French insolvency law provides for a list of transactions and payments that may be challenged in court if they have been entered into by a debtor during the hardening period:

- some must be cancelled by the court: these mainly include transactions or payments that constitute voluntary preferences for the benefit of some creditors to the detriment of other creditors (eg, transfers of assets made for no consideration, contracts under which the debtor's obligations significantly exceed those of the other party, payment of non-payable debts, payments using methods that are not commonly employed in the relevant business sector, protective measures, security granted for debts previously incurred by the debtor, transfer of assets or rights to a trust arrangement); and
- some may be declared void by the court: these mainly include transactions, payments or seizures made while the other party actually knew that the debtor was already insolvent at the date of such transaction or payment.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

The rank of creditors in insolvency proceedings mainly depend on whether they are secured or unsecured (and, if so, on the nature of the privilege or security interest securing each creditors' claim) as well as on the outcome of the insolvency proceedings, that may notably affect the substance of a lender's rights against a debtor. In summary, creditors are divided into secured and unsecured creditors. And, among secured creditors, those who have been granted a security vesting them with an effective retention right over assets or rights of the debtor or with ownership rights such as under a *fiducie* (to the extent the debtor has not retained use or enjoyment of the assets contributed to the *fiducie*) are, under certain conditions, entitled to be paid first or to ask for the transfer of the relevant assets.

In accelerated safeguard proceedings (ie, fast-track proceedings of a maximum duration of four months available to all companies in conciliation proceedings, regardless of their

size), all the creditors concerned by the proceedings (that may be picked up by the debtor prior to the opening of the proceedings) are collectively consulted on a reorganisation plan through a class-based system introduced by Ordinance of 15 September 2021. If the plan is not adopted within the required time limit, the proceedings will automatically terminate with no possibility for the court to impose a term-out.

In ordinary safeguard proceedings, the rules of adoption of a restructuring plan (which may feature a debt-rescheduling, debt write-offs, debt-to-equity swaps or a combination of these) differ depending on the size of the companies concerned. In companies with fewer than 250 employees and €20 million turnover or €40 million turnover (these thresholds being assessed on a consolidated basis for holding companies), the creditors whose payment terms are affected by the proposed restructuring plan are, in principle, consulted on the plan on an individual basis (save where the debtor has specifically requested to the insolvency judge that a class-based consultation process be organised). They can be imposed a term-out over a maximum period of 10 years by the court (subject to limited exceptions). In companies exceeding these thresholds (or in companies below these thresholds having specifically requested it), the creditors and, as the case may be, equity holders whose rights (or equity interest) are affected by the proposed restructuring plan are consulted within classes of affected parties (which notably excludes the holders of employment claims, claims secured by the new money and post-money privilege and claims secured by a *fiducie*). These classes are constituted based on certain criteria such as a sufficient economic interest test, compliance with intercreditor and subordination agreements and the requirement that secured creditors, unsecured creditors and equity holders (if affected by the plan) vote in separate classes. The restructuring plan may only be proposed by the debtor. The approval of the members of each class on the restructuring plan is obtained through a two-thirds majority vote within each class. For a restructuring plan to be approved despite the negative vote of one or more classes of affected parties, a cross-class cram-down mechanism is available provided that, in summary: (1) a majority of classes or at least one class that is 'in the money' voted in favour of the plan; and (2) such plan complies with the 'absolute priority rule' according to which the members of a class that voted against the plan must be fully repaid or compensated (by identical or equivalent means) when a more junior class is entitled to a payment or keeps an interest under the plan. The court may, however, waive this rule when necessary to achieve the plan's objectives (eg, treatment of strategic suppliers or equity holders) and such derogation does not unfairly prejudices the rights or interests of any affected parties. Further rules must be complied with when the cross-class cram-down is implemented against one or more classes of equity holders who have not approved the plan.

In either process (ie, through the regular process or through a cross-class cram-down), in order to be court-sanctioned, the plan must also satisfy a 'best interest of creditors' test: any affected member of a class who voted against the plan must not be worse off under the plan than it would have been in the event of liquidation proceedings, an asset sale plan or a better alternative solution. If no agreement is found on a plan through the class-based system or the plan is not approved by the court, the ordinary safeguard proceedings are directly converted into rehabilitation proceedings.

In rehabilitation proceedings, the rules for the adoption of a restructuring plan are essentially the same as in ordinary safeguard proceedings, subject to a few notable exceptions:

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- any affected party has the right to present an alternative restructuring plan that may compete with the debtor's;
- the cross-class cramdown may be implemented without the debtor's consent; and
- if no agreement is found on a plan through the class-based system, the creditors must be re-consulted pursuant to the individual consultation process in the framework of which the court may notably impose a 10-year term-out to dissenting creditors (subject to specific regimes such as the one applicable to claims benefiting from the new money lien or post-money lien).

Liquidation proceedings (but also rehabilitation proceedings, if no restructuring plan is possible) may end up with the adoption of a sale of assets plan (through which all or part of the debtor's assets constituting an autonomous branch of activity are sold to a third party) or in a sale of the debtor's assets on a piecemeal basis. When a sale of assets plan includes pledged or mortgaged assets, the creditors benefiting from these security interests may, if they hold a retention right, block the sale of the pledged assets until full repayment of their secured claim. If they do not hold a retention right or consent to the sale, they will be allocated a portion of the sale price calculated based on a ratio between the value of the pledged or mortgaged assets and the total value of the assets transferred to the purchaser. In the case of a sale of the debtor's assets on a piecemeal basis, the creditors are repaid out from (and up to) the liquidation proceeds according to their legal rank, which may be broadly summarised as follows:

- if applicable, the remuneration due to the manager(s);
- super-privileged claims of employees;
- legal costs falling due after the judgment opening the proceedings (other than lawyers' fees);
- claims secured by the new money privilege granted in conciliation proceedings;
- claims secured by a mortage;
- privileged claims of employees;
- claims secured by the post-money privilege granted in safeguard or rehabilitation proceedings;
- claims that have arisen after the opening judgment and that are in relation to the business operations or proceedings; and
- unsecured creditors.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Intercreditor agreements are recognised and commonly used in practice. As far as French insolvency law is concerned, the only provisions expressly recognising such agreements and requiring their application concern the preparation and adoption of a restructuring plan through the class-based consultation process available in both types of safeguard and rehabilitation proceedings. The law provides in this framework that the affected parties shall inform the court-appointed administrator of the existence of subordination agreements entered into prior to the opening of the safeguard or rehabilitation proceedings, otherwise those agreements will be unenforceable. If such information has been duly carried out, the court-appointed administrator of the debtor in safeguard or rehabilitation proceedings

will have the obligation to comply with these subordination agreements in the creation of classes of affected parties. In such class-based restructurings, the court will therefore have to control that subordination agreements have been duly applied before it sanctions a rehabilitation plan.

In other insolvency situations, although not directly bound to do so, the courts and insolvency practitioners generally take into account these agreements when addressing lien and ranking priorities. Senior creditors generally deal with this uncertainty by incorporating in intercreditor or subordination agreements clauses obliging junior creditors to transfer to senior creditors any payment received in disregard of the payment order instituted by the contractual agreement.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

In principle, all receivables, including discounted receivables should be declared in full.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

Potential liabilities may arise after the creditors have foreclosed the secured assets and have become the legal owner. From that point on, they become liable in their capacity as owners of the assets. For this reason, the documentation normally provides for the following alternative solutions:

- the assets are owned by the security agent for the account of the secured creditors;
- a newco is specifically created for the purpose of holding the foreclosed assets; or
- the creditors publicly auction the assets to avoid any potential liabilities.

The value of the foreclosed assets must be estimated by an independent expert and this valuation is binding on the secured creditor. If the expert's estimated value is greater than the amount of secured obligations discharged as a result of the security enforcement, the difference must be paid in cash by the secured creditor to the security provider. Parties usually agree to postpone the payment of that difference to such time as the secured creditor has been able to dispose the foreclosed assets to a third party for a consideration in cash.

In addition, disproportionate security may be set aside.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

As an answer to the companies' financial needs raised by the covid-19 crisis, a new legislation Relance has been enacted by the French government to strengthen the balance sheet and cashflows of small, medium-sized and mid-cap companies. Banks and credit institutions may grant in the form of participating loans denominated participatory recovery loans and alternative investment funds may grant in the form of bonds denominated Obligations Relance financings to eligible companies benefitting from a partial French state guarantee.

To benefit from the state guarantee, the financings must, among others, meet the following criteria:

- the obligors must be registered in France and evidence a turnover exceeding €2 million in 2019. They must not be subject to liquidation proceedings and if subject to safeguard or rehabilitation proceedings, a safeguard or rehabilitation plan should have been approved by a court prior to the signing date of such financings;
- the financings should provide for a minimum four-year grace period on amortisation, an eight-year duration and a capped maximum amount;
- the financings are also subject to the prior approval of a business or investment plan and shall be used to implement such a plan; and
- the loans shall contain an undertaking of the borrower not to use the loan to extinguish its existing financial indebtedness (eg, a PGE, loan guaranteed by the state).

For the avoidance of doubt, companies acquired under LBO transactions are not automatically excluded from these new financing instruments.

As from 16 November 2021, access to the participating loans has been simplified, as follows:

- the eligibility criteria for companies belonging to a group have been clarified and simplified;
- the criteria relating to the creditworthiness of the companies have been simplified so that no external rating is required; and
- it is now possible for companies to benefit from a six years grace period (versus four years previously).

Please note the use of the participating loans has been extended until 31 December 2023 and the above-mentioned eligible companies may issue the bonds until 31 December 2023.

Furthermore, a new insolvency procedure entitled *procédure de traitement de sortie de crise* was introduced by Law No. 2021-689 dated 31 May 2021. This procedure can be summarised as an accelerated and simplified judicial rehabilitation proceedings for small undertakings

(in terms of employees and turnover), whose purpose is the endorsement of a debt rescheduling. It will enter into force on 2 June 2023.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The governing law of the transaction documents is depending on the jurisdiction or nationality of the contracting parties. If both the seller and the purchaser are Hungarian persons (natural or legal), the governing law of the transaction documents is Hungarian. If any of the parties is a foreign person, the parties typically choose the law of that jurisdiction in which any of the parties is resident or they chose a completely neutral governing law, such as English law.

Generally Hungarian courts recognise foreign judgments, provided that such foreign judgments are in compliance with (1) Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Regulation 1215/2012), if foreign judgments are issued in an EU member state; or (2) Act XXVIII of 2017 on International Private Law (the IPL Act), if foreign judgments are issued in third countries. The IPL Act practically follows the structure of Regulation 1215/2012 as to the conditions of recognising foreign judgments in Hungary.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

The Hungarian legal and regulatory regime contains restrictions on acquisition of certain Hungarian companies or of the assets of such Hungarian companies. The relevant Hungarian laws (the FDI Act) is based on corresponding EU laws. In accordance with such Hungarian laws, a foreign investor may acquire control or a direct or indirect shareholding exceeding 25 per cent (10 per cent in the case of a joint-stock company) in a company established in Hungary and engaged in activities in strategic business (such as infrastructure, certain regulated industries (energy, insurance, etc), IT infrastructure, data protection) after the foreign investor has notified the competent minister and such minister acknowledged such notification (practically approved the acquisition).

For the purposes of the FDI Act, foreign investor is (1) an entity incorporated outside any EU member state, any EEA member state or Switzerland or a natural person having citizenship in third countries (ie, outside any EU member state, any EEA member state or

Switzerland) or (2) a Hungarian business entity, which direct or indirect shareholder is an entity incorporated outside any EU member state, any EEA member state or Switzerland or a natural person having citizenship in third countries (ie, outside any EU member state, any EEA member state or Switzerland (in the case of indirect ownership, even if the intermediate owners are incorporated in any EU member state, in any EEA member state or in Switzerland)).

As a response to the covid-19 pandemic, Hungary introduced some protective legislation in terms of foreign investment screening regime, according to which foreign investors also include entities or natural persons incorporated in, or having a citizenship of, any EU member state, any EEA member state or Switzerland.

In general, lending activity is a licensable financial activity in Hungary. Cross-border lending in Hungary is only permitted if the relevant credit institution has either passported its foreign licence (issued in an EU member state) to Hungary, and as a result is listed in the National Bank of Hungary's (NBH) register or established a branch office in Hungary. There is one exception of the licence, when the lending is provided on a one-off basis (ie, only to one borrower, one loan (no revolving facility)) and without any consideration. This, however, should be carefully checked on a case-by-case basis, as NBH has a very conservative view on pursuing licensable activities without a proper licence.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

In Hungary, the typical debt components of an acquisition financing includes subordinated debt (ie, capital contribution or shareholder loan provided as part of own equity and senior debt) mainly provided by commercial banks.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

In the event of takeover bids in respect of public companies, capital markets regulations require the investor to also provide evidence that it has sufficient funds to pay the consideration of the shares to be acquired by it.

In the case of the acquisition of regulated entities (such as credit institutions or insurance companies) the regulator requires that the investor properly evidences that it has the required amount of funds to purchase the given regulated entity irrespective of the type of the entity (ie, this rule also applies to private companies). Furthermore, in those cases, the legal origin of such funds (ie, that the funds are not deriving from unlawful sources or activities, such as money laundering, etc) must also be evidenced.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

The purpose of the use of funds is always determined in the relevant contracts, and the borrower must use the monies received for such purpose only, otherwise misuse of the proceed constitutes a breach of the contract. One exception though, when the purposes is not specified in detail, when the moneys might be used for general purposes. In such a case, though, the expectation is that the funds are used for legal purposes and to expenses, which are related to the borrower's business.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

In Hungary, financial institutions are entitled to provide financial services, which include the provision of credit and money lending. Financial institutions are credit institutions or financial enterprises. Credit institutions include banks, specialised credit institutions and cooperative credit institutions. Such a distinction is important, since they have to comply with different conditions in terms of establishment and authorisation. A bank and a specialised credit institution may take the form of a joint stock company or a branch; a cooperative credit institution may take the form of a cooperative; and a financial undertaking may take the form of a joint stock company, a cooperative, a foundation or a branch. The amount of initial capital required to set up a financial institution may also differ from one institution to another. The minimum initial capital for a bank is 4 billion forint, for a cooperative credit institution 300 million forint, for a specialised credit institution the minimum initial capital is set by a separate law, and for a financial undertaking providing credit and loans a minimum of 150 million forint is required. The establishment of a financial institution requires a licence from NBH. An important difference is that credit institutions can be established under a separate authorisation procedure and require a different authorisation procedure to start operating. In the case of financial undertakings, the authorisation to establishment of the given financial undertaking includes the final authorisation for starting its operation as well.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Currently in Hungary no withholding tax is payable on any payments.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

In Hungary, Government Decree 782/2021 (XII.24.) on consumer credits provides that mortgage credit contracts tied to a reference rate, the reference rate for a limited period (from 1 January 2022 to 30 June 2023) shall not be higher than the reference rate set in the contract on 27 October 2021.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Indemnities in Hungarian practice include tax indemnity, under which the borrower shall pay to the lender an amount equal to the loss, liability or cost which that lender determines will be or has been (directly or indirectly) suffered for on account of tax by that lender. Another common indemnity is the currency indemnity, whereby if an amount must be converted from one currency to another and if such conversion results in a loss for the lender, the borrower is obliged to pay such loss to the lender.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

Interests in debt can be freely assigned among lenders, unless the parties agreed to exclude or limit such assignment. Lenders usually insist to have the possibility to assign their interest in a debt and do not agree to entirely remove it from their agreements. As a compromise, however, white lists or blacklists can be included, whereby borrowers and lenders pre-agree to which entity such interest can be assigned.

Requirements to act as agent or trustee

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Hungarian civil law regulates the institution and role of the collateral agent. The collateral agent holds and enforces the pledges, charges and/or real estate mortgages (security) for the benefit of the lenders. The collateral agent may be appointed by the lenders in writing. The appointment could be included in the relevant security document, the financing agreement or in any other instrument (such as a separate collateral agent appointment letter). The collateral agent shall act in its own name and for the benefit of the lenders. The appointment of the collateral agent is only effective against third parties once the collateral agent is registered in the various registries as such. During the period of registration, the lenders are not entitled to exercise their rights under the security; however, they shall be liable for the conduct of the collateral agent as if they had acted themselves. From the date of registration, only the collateral agent is entitled to make any declarations or do any acts in relation to the security (in particular, the enforcement of a security). In this context,

the collateral agent acts in its own name, for the benefit and on behalf of the lenders. The assignment of a secured claim shall not affect the rights and obligations of the collateral agent. The revocation of the appointment of the collateral agent may be affected jointly by the then current lenders, by the appointment of a new collateral agent or by registering all lenders as pledgees, charges or mortgagees. The revocation of the appointment if the collateral agent is effective against third parties from the date on which the new collateral agent or the pledgees, charges or mortgagees are entered in the relevant registries.

Debt buy-backs

12 May a borrower or financial sponsor conduct a debt buy-back?

Practically a debt buy-back is not restricted in Hungary. However, to avoid delicate situations in an insolvency proceeding (where, as a result of the buy-back, financial sponsors will also be considered as creditors of the insolvent borrower and might have as much voting rights as other lenders) it is not market practice to include such provisions in a loan agreement.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

This is not market practice in Hungary.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

Hungarian law does not limit the costs and taxes associated with the provision of affiliate guarantees, nor does it limit the provision of guarantees by affiliates incorporated abroad.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

Hungarian law does not prohibit financial assistance, but only allows it in a limited scope, provided that certain conditions are met. A public limited liability company may provide financial assistance for the acquisition of its shares under market conditions, at the expense of its assets available for dividend payments. However, this requires a resolution with the approval of the general meeting of shareholders, on a proposal from the board of directors, which must be adopted by a three-quarters majority.

The company may not provide financial assistance if its own capital is less than, or would be less than, the share capital of the company as a result of the financial assistance.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

The borrower may provide the following types of security in connection with a financing:

- pledge over movable assets, receivables, bank accounts (and bank account receivables), IP rights, shares or quotas; airplanes, ships;
- mortgage over real estates;
- security deposit of bank accounts and shares;
- call option right (for a security purpose) over movable assets, real estates and shares or quotas;
- security assignment of receivables;
- suretyship; and
- guarantee.

In Hungary, until the launch of the new Hungarian Civil Code in 2014, floating charge was available over all type of assets. The new Civil Code has tweaked this regulation a bit, and introduced a very similar instrument, which practically a floating charge (however without the crystallisation procedure), but over only certain assets. In other words, certain assets cannot be subject of a floating charge, the ownership of which is registered in public registries. This means that real estates, quotas, IP rights, airplanes and ships shall not be subject of a floating charge.

Future assets can be subject to security in a sense that the pledgor has not already obtained such an asset (real estate or a car) or the given future asset is not yet existing (bank account to be opened in the future).

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

The perfection steps of a security are depending on the type of the security. Pledges and mortgages must be registered in the relevant registries (land registry in case of real estate mortgage, collateral registry in case of pledge over movable assets, receivables, bank accounts or shares, court of registration in case of quota pledge, the Hungarian Intellectual Property Office in the case of IP rights, separate register for airplanes and ships in case of pledge over airplanes and ships). In the case of possessory pledges and security deposits, the pledged or deposited assets must be handed over to the beneficiary. In case of security assignment or call option for security purposes, the assignment or the call option might be registered in the collateral registry; however, it is not a perfection requirement (without registration, these types of security are considered validly established), it has relevance in

the case of the liquidation of the security provider. If the security assignment or the call option for security purposes is in fact registered, in a liquidation procedure, the beneficiary of such security will be considered as secured creditor, and hence enjoys priority in satisfaction of claims.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

In Hungary, no renewal procedure is required to maintain the validity of a security. Given that in Hungary security has an accessory nature, the lien exists as long as the underlying claim exists.

If, however, the underlying claim is amended during its existence (especially in its pricing or term), it is common practice to enter into a security confirmation agreement with the security provider, who acknowledges that the security provided by it keeps securing the amended financing agreement.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

Hungarian law does not contain any rule requiring the consent of the 'works council' or similar for the approval of guarantees or security given by the company. This notwithstanding, the articles of association of the company may contain restriction in relation to the entry into any guarantee or security agreement by requiring the express consent and authorisation of the shareholders.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Hungarian civil law regulates the institution and role of the collateral agent. The collateral agent holds and enforces the pledges, charges and/or real estate mortgages (security) for the benefit of the lenders. The collateral agent may be appointed by the lenders in writing. The appointment could be included in the relevant security document, the financing agreement or in any other instrument (such as a separate collateral agent appointment letter). The collateral agent shall act in its own name and for the benefit of the lenders. The appointment of the collateral agent is only effective against third parties once the collateral agent is registered in the various registries as such. During the period of registration, the lenders are not entitled to exercise their rights under the security; however, they shall be liable for the conduct of the collateral agent as if they had acted themselves. From the date of registration, only the collateral agent is entitled to make any declarations or do any acts in relation to the security (in particular, the enforcement of a security). In this context, the collateral agent acts in its own name, for the benefit and on behalf of the lenders. The

assignment of a secured claim shall not affect the rights and obligations of the collateral agent. The revocation of the appointment of the collateral agent may be affected jointly by the then current lenders, by the appointment of a new collateral agent or by registering all lenders as pledgees, charges or mortgagees. The revocation of the appointment if the collateral agent is effective against third parties from the date on which the new collateral agent or the pledgees, charges or mortgagees are entered in the relevant registries.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Generally, if the underlying (secured) obligation exists, the relating security also exists. If the secured obligation terminates, the relating security cease to exist by virtue of law and the release or deregistration from the various registries is a technical action of the beneficiaries (but also an obligation). If the secured obligation does not cease, but the parties agreed to terminate one or more security, it is the beneficiaries' discretion to determine on what terms they agree to release the security.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

The fulfilment of the following conditions will constitute a fraudulent transfer in accordance with applicable Hungarian laws:

- by the fraudulent transfer the basis of satisfying a third party's claims owed by the transferor is deprived partially or entirely; and
- the transferee acted in bad faith; or
- the transferee acquired gratuitous advantage from such transfer (eg, it has not paid any purchase price for the transferred asset).

If the following conditions are met, the transfer will not be effective vis-á-vis such third party, and the transferee must tolerate if such third party forecloses the transferred asset. In addition, if the transferee has sold the transferred asset in bad faith to another person, it shall be liable for the claims of the third party up to the value of the transferred asset.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

The typical documents in an acquisition financing transactions are as follows:

- non-binding offer (term sheet);

- binding offer (term sheet);
- facility agreement;
- security documents; and
- conditions precedent documents (including, without limitation corporate documents, due diligence reports, legal opinions or tax certificates).

Debt commitment letters are not common in Hungary per se, banks rather issue indicative (non-binding) or binding term sheets (offers), both of them listing the conditions of the financing. The binding term sheet (offer) can be considered as debt commitment letter, as if such binding term sheet is signed by the lender and accepted by the borrower, the bank is obliged to prepare the finance documents and execute them (unless any of the parties withdraws from the agreement).

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

No such distinction is market standard in Hungary. Parties may have non-binding offers or binding offers. In the case of a non-binding offer, either party is entitled to withdraw any time. In the case of a binding offer, the withdrawal is only possible if any of the key conditions included in the offer is not fulfilled.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The typical conditions precedent to funding in Hungary are as follows:

- corporate documents (eg, most recent articles of association, company registry extract, shareholders' resolution);
- finance documents (eg, loan agreement and the relating security documents);
- acquisition documents (eg, purchase agreement; joint venture agreement; etc);
- evidence that each security interest has been perfected;
- reports (legal, financial, technical due diligence reports or if applicable environmental, insurance due diligence reports);
- legal opinions;
- if applicable, consent letters from third parties relating to the acquisition;
- tax certificates; and
- evidence that all relevant fees have been paid.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Commitment letters usually include market flex provisions, according to which lenders are entitled to change the pricing of the loan (usually increasing the margin) if the then existing economic, regulatory, business, legal circumstances so require.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

This is not relevant for Hungary.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Usually, the security package relating to the financing agreement includes pledge or assignment of all receivables of the borrower (including any potential monetary claims of the borrower under the acquisition documents), hence it is important for the lenders that the assignment or pledge of such claims is not prohibited in the acquisition documents. Although, Hungarian law allows the assignment of claims irrespective of such a prohibition, the assignor will still be held liable for breaching the terms of the agreement. The acquisition agreement usually does not contain liability protections afforded to lenders.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

The filing of the commitment letters and acquisition agreements is required if the target company is a regulated entity. The acquisition of a regulated entity is subject to the prior approval of the Hungarian regulator. For the approval process the acquisition agreement (which expressly provides that the completion of the acquisition shall only occur after the Hungarian regulator has given its approval) and, if the purchase price is partially funded from external sources, the commitment letter must be filed with the Hungarian regulator.

Although joint stock companies need not to file to the Budapest Stock Exchange the commitment letters or the acquisition agreements, still a declaration shall be filed if such a company acquires another company.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

To initiate enforcement against collateral, the lender must have a due and unpaid claim against the debtor. It practically means that if lenders intend to enforce security prior to the final maturity date of the loan agreement, they shall accelerate the loan agreement in order to enforce the collateral. If a lender intends to enforce its claims against collateral, it might do so via (1) out-of-court enforcement procedure or (2) court enforcement procedure. In an out-of-court enforcement, the lender might sell the pledged asset (in the name of the pledgor); or it might acquire ownership interest over the pledged asset; or in case of pledged receivables, the lender is entitled to instruct the debtor of the pledged receivable to pay any amounts to it instead of the pledgor. Prior to the out-of-court sale or the acquisition of the pledged assets by the lenders, they shall notify certain persons (listed in the Hungarian Civil Code) of the out-of-court enforcement procedure (most importantly other pledgees), who might join the procedure. In case of a court enforcement procedure, if the security documents, certain key terms of the loan agreement (including amongst others, principal amount, interest, maturity date) and the acceleration notice of the loan agreement are incorporated in a Hungarian notarial deed, the notary will attach an enforcement writ to the notarial deed and send the documents to the court bailiff for immediate enforcement. If any of the above documents are not incorporated in a Hungarian notarial deed, the lenders shall initiate a civil law procedure in order to obtain an enforceable deed (practically the final court order) on the basis of which the court enforcement procedure can be initiated. If during the enforcement (whether court enforcement or out-of-court enforcement) procedure, a liquidation procedure is commenced against the debtor or the security provider, enforcement procedure is terminated by virtue of law and the lenders are only able to enforce their claims within the scope of the liquidation procedure.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

This is not relevant for Hungary.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

In a bankruptcy procedure (the aim of which is agree with the creditors on the restructuring of the creditors' claims without dissolving the debtor entity), the creditors are not entitled to demand payment of any matured claim (including interest and default interest), nor they are entitled to enforce the security securing their claim. In a liquidation procedure (the aim of which is to settle creditors' claims by way of selling the debtor's assets, after which the debtor is dissolved) the debtor may request a moratorium up to 45 days to settle the claims

of the creditors. If the debtor was unsuccessful in paying all the claims against it, the liquidation procedure will continue after the elapse of the period of the moratorium.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

No automatic clawback of payments is recognised in Hungarian during insolvency procedures. However, any creditor, and/or the liquidator (on behalf of the debtor) may file a claim within one year (as forfeit deadline) of the date of publication of the commencement of the liquidation to contest contracts concluded by the debtor within:

- five years prior to the date when the court received the petition for opening liquidation proceedings or thereafter, if those aimed at concealing the debtor's assets or to defraud any creditor, and the counterpart to such contract had or should have had knowledge of such intention;
- three years prior to the date when the court received the petition for opening liquidation proceedings or thereafter, if those aimed at transferring the debtor's assets without any compensation or at undertaking any commitment to provide encumbrances over any assets of debtor without compensation, or if the stipulated consideration constitutes unreasonable and extensive benefits to a third party;
- 90 days prior to the date when the court received the petition for opening liquidation proceedings or thereafter, if those aimed at giving preferential treatment and privileges to any of the creditors, in particular the amendment of an existing contract to the benefit of a creditor, or to provide financial collateral with respect to a previously unsecured claim;
- three years prior to the date when the court received the petition for opening liquidation proceedings or thereafter, if those aimed at transferring ownership, transferring or assigning rights or claims or calling an option, each by way of security, on the basis of which the beneficiary failed to perform or not properly performed its settlement obligation towards the debtor, or it failed to deliver to the debtor any collateral which exceeds the secured claim; if the beneficiary failed to register the acquisition by way of security of the ownership interest, right or claim in the Collateral Registry or the call option in the land registry, the existence of the conditions to challenge the contract shall be presumed.

If the contest is successful, the provisions of the Hungarian Civil Code pertaining to invalid contracts shall apply. Furthermore, the liquidator, on behalf of the debtor, shall be entitled to reclaim within a one-year forfeit deadline from the date of publication of the notice of liquidation to contest any service the debtor has provided within a 60-day period preceding the date when the court received the petition for opening liquidation proceedings or thereafter, if it was provided to give preference to any one creditor and if such service is not usually provided under normal circumstances. Prepayment of a debt is, in particular, considered as giving preference or privileges to a particular creditor.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

The main principle in an insolvency procedure that secured creditors' (having in rem security) claims shall be satisfied first. From the proceeds of the sale of a pledged asset, that creditor's claims must be paid first who had a pledge over such asset. Within secured creditors, who have pledge over the same asset of the debtor, the ranking is subject to the date of creating the given pledge. Otherwise, the order of satisfaction of creditors' claims is as follows:

- costs of liquidation;
- claims secured by a pledge, to the extent any claims remained after satisfying such claims from the proceeds of the sale of the pledged asset and to the extent the pledge was created before the commencement of the liquidation proceeding;
- alimony and life-annuity payments, compensation benefits, income supplement to miners, which are payable by the debtor, monetary aid granted to members of agricultural cooperatives;
- claims of private individuals not originating from non-economic activities, with the exception of bonds;
- debts owed to social security funds, taxes and public duties repayable as taxes;
- other claims;
- interest, default interest and penalties; and
- claims of shareholders, management, executive officers, close relatives and subsidiaries.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

In Hungary, contractual subordination of secured creditors is not recognised, as to create a valid security, such security must be registered in the relevant registry. Hence, the subordination can be easily created legally, if the security of different ranking creditors is registered in the corresponding ranking order in the respective registry. The ranking of a security is determined by the date of its establishment. In such case the higher-ranking creditor's claims satisfied first in the insolvency procedure. As an example, if a first, second and third-ranking mortgage is registered in respect of a real estate, which secures a debt up to the amount of €2 million (first ranking), €1.5 million (second ranking) and €500,000 (third ranking), in the case of the liquidation of the owner of the real estate, upon sale of the real estate for a purchase price of €5 million, the first ranking creditor receives €2 million, thereafter the second ranking creditor receives €1.5 million and the third ranking creditor receives €500,000. The remaining €1 million will go back to the liquidation pool and will be used to satisfy unsecured creditors' claims.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

There is no special treatment for original issue discount (OID) or discount debt instruments in an insolvency proceeding. Normally, the creditor shall file its claims against the debtor and the creditor must provide proper evidence to the insolvency administrator as to the amount of its claims.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

In the case of an enforcement against collateral by a secured creditor, secured creditors have a settlement obligation towards the debtor, meaning that any amount obtained during the enforcement process, which exceeds the creditors' claims must be returned to the debtor. Otherwise, creditors do not have other responsibilities (eg, environmental liabilities).

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

No new legal developments are contemplated in the near future in relation to acquisition financing.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The law applying to financing agreements for cross-border transactions is determined based on private international law (Act on General Rules for Application of Laws in Japan). Its principal thought is that the governing law of a contractual relationship should be determined by agreement of the parties, taking account of several factors. As such, in the case of cross-border finance transactions involving Japan, in addition to Japanese law, English law and New York law are often designated as governing law because of English law and New York law having historically been used as the governing law in numerous cross-border transactions for many years. However, this principle applies only to laws regarding contractual relationships, such as loan agreements, and does not apply to other laws such as the Code of Civil Procedure or laws related to procedures of compulsory execution. In cases such as collateral agreements involving compulsory execution for a security created over assets, the law of the location or domicile of the collateral or the person establishing the security interest is usually selected as the governing law.

If a foreign company files a lawsuit against a Japanese company in a foreign court and wins the case, the foreign court's judgment can be enforced in Japan by obtaining a judgment of execution of the foreign court's judgment from a Japanese court. For the judgment of a foreign court to be enforced, it must satisfy all requirements of article 118 of the Code of Civil Procedure, including the following requirements:

- in the event that the debtor did not appear to defend the relevant suit, action, or procedure, the debtor was personally served with a summons commencing the action while within the jurisdiction of the relevant court, under Japanese concepts, or process was served on the debtor in Japan with the assistance of the judicial authorities of Japan; and
- reciprocity exists at such time as to the recognition by the courts of the foreign jurisdiction of final and conclusive judgments obtained in the courts of Japan.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

The Foreign Exchange and Foreign Trade Act, while maintaining the principle of freedom of foreign transactions, provides restrictions on certain acquisitions by foreign entities. In other words, it requires that foreign investors submit an ex-post facto report when they

engage in certain types of transactions or activities which are referred to as inward direct investment, and requires advance notification in certain cases to ensure national security, maintain public order, protect public safety, and ensure the smooth operation of the Japanese economy. The Minister of Finance and the minister having jurisdiction over the business will conduct an examination.

In addition, a foreign investor who acquires shares or equity interest in an unlisted domestic company through an acquisition by another foreign investor may be required to submit advance notification and be examined based on such notification as well.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

The basic structure of acquisition financing is as follows.

The sponsor establishes an SPC, the SPC receives equity investment in the form of common stock from the sponsor and a senior loan from the senior lender and uses such cash to purchase the target company's stock and repay the target company's existing loan. The sponsor is typically a buyout fund, but in the case of a management buyout (MBO) by the management of the target company, it can be the buyout fund and the target company's management (pseudo-MBO) or only the target company's management (pure MBO).

In some cases, only one financial institution is the senior loan lender. However, in many cases, the amount of the acquisition is so large that one financial institution alone cannot cover the entire amount of funds required for the acquisition, and multiple financial institutions may provide senior loans from the beginning, in many cases, one financial institution acts as the lender and then transfers the loan to multiple financial institutions. It is also common for senior loans to be provided in separate facilities such as bridge loans, term loans A, term loans B, and commitment lines. Mezzanine financing may be obtained from mezzanine investors when equity investment from the sponsor and senior loans are not sufficient to cover the acquisition costs.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

There are no statutory rules requiring certainty of financing for acquisitions of public companies in Japan. Also, 'certain funds' in acquisition finance transactions have not become established market practice yet. However, there are some cases to pay attention to such as the tender offer bid (TOB).

Under the Financial Instruments and Exchange Law, a TOB is compulsory in principle for any purchase of shares of a listed company in which the shareholding ratio after the purchase exceeds one-third. Therefore, for an acquirer to acquire control of a listed company by

purchasing its shares, a TOB is required. In this case, the method of procuring funds for the TOB and the party from whom the funds are to be procured are subject to disclosure in the TOB registration statement and the offeror is required to attach a loan certificate to the TOB registration statement as a document sufficient to show the existence of funds required for the TOB. The loan certificate is required to ensure, with a reasonable degree of certainty, that it is possible to procure the funds required for the settlement of the TOB.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

In Japan, there are no legislative restrictions on the borrower's use of proceeds from loans or debt securities.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

In Japan, only banks licenced under the Banking Act and money-lending institutions registered under Money Lending Business Act are permitted to arrange or extend loans as a business. Note, it is possible for companies other than such financial institutions to acquire outstanding loan receivables.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Under the Japanese Income Tax Act, the scope of taxation on non-residents or foreign corporations is limited to domestic source income in Japan. A person who pays domestic source income to a non-resident or foreign corporation shall be obliged to withhold and pay income tax and special income tax for recovery at the time of payment. Even if such payment is conducted outside of Japan, as long as the payer has a domicile or an office, etc, in Japan, it shall be deemed to be done in Japan and subject to withholding tax. The withholding tax is calculated by multiplying the amount of domestic source income paid by the tax rate. There are several variations of domestic source income and its tax rate. In the case of interest payments related to indebtedness, the borrower shall be responsible for the withholding tax of 20.42 per cent. Note, gross-up clauses are generally included in all transactions in Japan to ensure that the lenders receive all payments free and clear of any withholdings or deductions.

If a tax treaty has been concluded between Japan and the country of residence of the non-resident, the withholding tax rate may be exempted or reduced in accordance with the provisions of the tax treaty. If the non-resident wishes to receive such exemption or reduction, the non-resident needs to submit a notification of tax convention, etc. to the director of

the tax office of the payer's tax payment district via the payer of the domestic source income by the day before the payment date. This is not an obligation for the payer.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

The maximum interest that can be charged is mainly stipulated in two laws: (1) the Interest Rate Restriction Act and (1) the Act Regulating the Receipt of Contributions in Japan. Under (1), the following rate ceilings are set:

- where the amount of the principal is less than ¥100,000: 20 per cent per annum;
- where the amount of the principal is ¥100,000 or more but less than 1 million yen: 18 per cent per annum; or
- where the amount of the principal is ¥1 million or more: 15 per cent per annum.

Any interest exceeding such ceilings shall be void. And under (2), the maximum interest rate when lending money as a business is set at 20 per cent per year, and if a lender contracts interest at a rate exceeding that, the lender will be punished by imprisonment for not more than five years or a fine of not more than 10 million yen, or both.

Furthermore, with respect to the calculation of the maximum interest rate, the relevant laws and regulations contain provisions on 'deemed interest', which means that, in principle, any money other than the principal received by the lender in connection with a loan, regardless of whether it is a discount fee, commission, research fee or any other name, is deemed to be interest. With respect to the arrangement fees and agent fees that are often paid in acquisition finance, it is generally understood that they are not considered to fall under the category of interest or deemed interest because they are not a consideration for the use of the principal, but for arrangement services or agent services provided independently of the loan. In addition, with respect to the commitment fees that are often paid in acquisition finance as well, the Act on Specified Commitment Line Contract stipulates that commitment fees are exempt from the regulation of deemed interest if certain requirements are met.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

A breach of representations, warranties or covenants, or increased cost, taxes or currency conversions. would customarily be provided by the borrower to lenders in connection with financing as indemnities.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

Lenders can assign their interests to each other unless they are still obliged to lend additional amounts to borrower. Under the Civil Code, for an assignee to assert against a borrower or third party, it is sufficient that the assignor gives notice to the borrower, or the borrower acknowledges assignment. But in the case of a syndicated loan, considering an administration being provided by the agent, notifying to the agent would be needed as well in addition to the notice above-mentioned. With respect to how to satisfy the requirements for assertion of assignment of interests against borrower or third party, it was common practice to obtain an acknowledgement without objection from the borrower until the Civil Code came into force in 2020. But this method was abolished under the amended Civil Code and it is now possible for the borrower to assert the assignee with respect to all grounds that can be asserted to the assigner that have arisen before the borrower received notice of the assignment. As such, as the assignee, it is necessary to have the borrower waive any right of setoff against the assigner in advance.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

In Japan, there is no rule governing whether an entity can act as an administrative or collateral agent. However, as trust businesses are regulated under the Trust Business Act and the Act on Provision of Trust Business by Financial Institutions, it is necessary to comply with these laws.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

In Japan, a debt buy-back by a borrower or a financial sponsor is not prohibited. However, it is generally understood that many loan agreements executed in Japan prohibit lenders from transferring or assigning their loans to a borrower.

Exit consents

13 | Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

It is permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements, but it is not seen very often in Japan.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no restrictions on the provision of related company guarantees. However, on the assumption that directors must comply with a duty of care and are not permitted to take any actions that harm the interests of the shareholders, they should make sure to carefully analyse whether the terms and conditions of company guarantees, including the amount of guarantees, the term, and the interest rate, are reasonable. Note, this is more required in cases where there are minority shareholders.

There are no limitations on the ability of foreign-registered related companies to provide guarantees.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

In Japan, there is no statutory restriction regarding the provision of guarantees or collateral or financial assistance in association with the acquisition of shares per se. However, in light of the obligations of directors including the duty of care under the Companies Act, provisions of guarantees that harm the interests of the shareholders are not allowed.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

In Japanese law, a general form of security interest in all assets similar to a floating charge or blanket lien is not available. With certain limited exceptions, collateral in Japan must be granted on an asset-by-asset basis. In the case of an acquisition finance transaction in Japan, since this is a high-risk and high-return finance compared to ordinary corporate loans, and has a strong cash flow finance character, the security package typically covers all assets including shares, claims, real estate and intellectual property rights, of the target company and target company group unless the creation of a security interest is prohibited by another agreement that the target company executed with another company.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Shares

Since creating security interest in shares is possible to acquire control of entire target group companies, it can be said that shares are the assets that should be taken as collateral with the highest priority among all types of assets.

To create a pledge on listed shares, it must be transferred to the pledge column in the book-entry account held by the person who will be the security interest holder under the Act on Book-Entry Transfer of Corporate Bonds and Shares.

In the case of shares other than listed companies and shares of a company issuing stock certificates, the agreement between the pledger and the pledgee on the establishment of the pledge as well as the delivery of the stock certificate are needed, and possession of the stock certificate is a requirement for opposition to the issuing company and third parties. Meanwhile, in the case of shares of a company not issuing stock certificates, the agreement on the establishment of a pledge is needed, and the shares must be registered in the shareholders' register to oppose the issuing company and third parties.

Receivables

Receivables is one of the most common types of collateral in Japan and will be subject to security interest by a pledge or a security assignment. To have a perfect security assignment, there are the following three methods:

- date-certified notice to the underlying obligator (generally delivered by certified mail);
- obtaining the date-certified consent of the underlying obligator (date certification is done by a notary public); or
- registration of the pledge or assignment at the Legal Affairs Bureau.

Among these options, date-certified consent is generally used.

Real estate

A mortgage is usually established on real estate. A mortgage is established by agreement between the mortgagor and the mortgagee, and the requirement for opposition to third parties is registration.

Movables

In the case of movables, it is important to be able to provide security without physically moving them due to its nature. For this reason, the creation of a movables security is done by way of a security interest in transfer rather than a pledge. A security interest in the transfer of movables is established by agreement between the security interest provider

and the security interest holder. A security interest in the transfer of movables can also be asserted against a third party by delivery under the Civil Code (usually by revision of possession) or by registration of the transfer of movables.

Intellectual property rights

Intellectual property rights are usually subject to pledge. For patents, utility models, designs, and trademarks, the agreement between the pledger and the pledgee and the registration are the requirements to take effect. For copyrights, on the other hand, the agreement between pledger and pledgee is the requirement to take effect, and registration is the requirement to oppose third parties.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

In Japan, once a security interest is perfected, renewal procedures to keep the lien valid and recorded are not needed except for the registration of a security assignment of receivables and movables. In this case, the duration of registration is determined (movables: 10 years from the date of application for registration; and receivables: either 10 years or 50 years from the date of application for registration). Although such registration is not often used in practice, it is important to note that when the term expires, the registration will be forcibly cancelled and the requirements for opposition to third parties will be extinguished.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

There are no such requirements under Japanese law.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

In Japanese law, a security interest is created for each individual creditor, and a person who would act as an agent for such creditor may not hold such security interest on behalf of all creditors. In addition, if a creditor assigns a secured claim to a third party, the security interest in such secured claim will incidentally be assigned to the third party.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

In Japan, there are no statutory protections afforded to creditors before collateral can be released.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

The Civil Code provides the right to rescind an act of a debtor that harms the creditor (fraudulent act) through an action, and to restore to the debtor the property or rights that have been lost from the debtor's property (right of rescission of fraudulent act). The amendment of the Civil Code in 2020, in addition to the act of diminishing property, which is a typical fraudulent act, clearly stipulated as fraudulent acts: the debtor's intention to conceal, the act of harming the creditor due to the bad faith of the beneficiary, the act of partiality, and excessive payment in kind.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

In acquisition financing (a senior loan), the first document that will be drafted is a commitment letter. The commitment letter consists of three main parts. The first part is the main part of the commitment letter, in which the prospective lender expresses its commitment to execute the financing. The second part is the term sheet, which sets forth the main terms and conditions of the financing and is attached as an exhibit to the commitment letter. The third is the potential lender who has promised to provide the financing needs to be appointed by the borrower as the financing provider, and this appointment is evidenced by the mandate letter, which is often attached as an exhibit to the commitment letter as well.

After the commitment letter is submitted and the potential lender receives the mandate letter from the borrower, the acquisition financer proceeds to draft the final agreement based on the term sheet (this process is generally referred to 'documentation'). The documentation is the process of solemnly incorporating the items agreed to in the term sheet into the agreement, and there are not many new problems that arise during the documentation. However, regarding collateral, at the time the term sheet is prepared, it is often limited to the type and scope of assets to be collateralised ('security package'), and the details of the terms and conditions of the collateral agreement are mainly discussed through the documentation. The documentation may also be affected if there are matters that were not settled at the term sheet stage and were carried over to the documentation stage, or if there

are changes in the business, assets or management of the target group companies after the term sheet was fixed.

If the acquisition financing includes mezzanine investment, a mezzanine commitment letter (including a mezzanine term sheet and a mezzanine mandate letter) is also prepared as in the case of a senior loan.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

In current practice, virtually all of the terms and conditions applicable to acquisition finance transactions are often set forth in the term sheet, which are comparable to final contracts in terms of quality and quantity. As such, a fully underwritten commitment letter is typically prepared for the acquisition financing.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The following items are understood as typical conditions precedent:

- obtaining all required internal approvals;
- the execution of definitive documentation;
- the accuracy of the borrower's representations with no change of acquisition or equity structure; and
- no business material adverse change.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

In Japan, flex provisions are not commonly included in commitment letters. In large transactions requiring broad syndications, pricing flexibility is sometimes seen, but this is still quite rare. Structural flex is not typically requested or granted.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

In Japan, securities demands are not a key feature.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Conditions precedent, representations, warranties, covenants, and reason for loss of profit on maturity, etc.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

In Japanese law, commitment letters and acquisition agreements are not required to be publicly filed. However, in the case of the tender offer bid, the potential lender will issue a loan certificate based on the commitment in the commitment letter, which must be attached to the tender offer statement, which is publicly filed.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Lenders freely enforce against collateral and will be entitled to receive payment in priority to other general creditors by exercising their security interests. This basically applies to bankruptcy proceedings, civil rehabilitation proceedings, and special liquidation proceedings as well. In such proceedings, a security interest is considered a right of separate satisfaction and, in principle, the security interest can be enforced (eg, by filing a petition for auction) regardless of whether such proceedings have been commenced. However, under the Corporate Reorganization Act, in corporate reorganisation proceedings, security interests may not be enforced outside of the reorganisation proceedings.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

In Japan, DIP financing is allowed as loans provided during the period between the filing of a petition for proceedings under the Civil Rehabilitation Law or the Corporate Reorganization Law and the conclusion of the proceedings.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

To prevent the dissipation of the debtor's property due to debt collection actions by creditors during the period between the filing of a petition for commencement of bankruptcy proceedings and the order of commencement of bankruptcy proceedings, the court, if it finds it necessary, upon the petition of an interested person or by its own authority, may order the discontinuance of any proceedings other than bankruptcy proceedings during such period. Meanwhile, an automatic stay does not arise upon the filing of a petition for insolvency.

There is no concept of adequate protection under Japanese law.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

If a borrower is unable to pay all lenders in full, but makes payments that favour only certain lenders, the payment may be denied by the bankruptcy trustee and the lender who received the payment may be required to return the money received. In addition, if the payment is malicious, there is a risk that it will be considered as grounds for considering the debt non-dischargeable, and the bankruptcy proceedings may result in the loss of discharge.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Priority relationships are established among bankruptcy claims, and the following four types of bankruptcy claims are distinguished with respect to the order of distribution in accordance with article 194(1) of the Bankruptcy Law: (1) priority bankruptcy claims (eg, tax claims); (2) general bankruptcy claims; (3) subordinated bankruptcy claims (eg, interest claims after commencement of bankruptcy proceedings); and (4) consensually subordinated bankruptcy claims (eg, subordinated loan claims). Unless all first-priority bankruptcy claims have been satisfied, no distribution will be made to the next-priority bankruptcy claims.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

In acquisition financing where mezzanine financing is conducted, an intercreditor agreement is executed among the senior lender, mezzanine investor, borrower, and the agent for the senior loan and mezzanine financing, which often stipulates the superiority, inferiority, and other relationships of the senior lender and mezzanine investor. There are two methods

for subordinating mezzanine loan to senior loan: (1) the relative subordination method and (2) the absolute subordination method. The relative subordination method is one in which the senior lender, mezzanine lender, and borrower agree on the terms of subordination of the mezzanine lender to the senior lender. Therefore, the said agreement is merely a contractual agreement between the senior lender, mezzanine lender and the borrower, and no preferential subordination relationship arises with general creditors or third parties such as the bankruptcy trustee. On the other hand, the absolute subordination method means that the mezzanine lender and the borrower agree that the mezzanine loan shall be subordinated to the bankruptcy claims as defined in each item of article 99(1) of the Bankruptcy Code in the event of the commencement of bankruptcy proceedings. In the case of the absolute subordination method, it is possible to assert a preferential-subordinated relationship to the bankruptcy trustee. However, the mezzanine lender will be subordinated not only to the senior lender but also to all general creditors of the same rank. For this reason, if the mezzanine lender is an investor independent of the sponsor, it is unlikely that the mezzanine lender will accept the absolute subordination terms and the relative subordination method will usually be adopted.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

In Japan, shares and bonds, etc, are basically issued at face value and discount is considered in the process to determine the face value.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

A secured creditor is not normally exposed to risk regarding potential liabilities such as environmental liabilities in Japan.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

'Shareholders' Meeting without a Designated Location' – Under the Companies Act, because a resolution for a 'place' is required when convening a shareholders' meeting, it is generally understood that the existence of a physical location is essential to hold a shareholders' meeting, and that a virtual-only shareholders meeting that does not need the existence of a venue cannot be held. However, a virtual-only shareholders' meeting facilitates shareholders including those in remote areas to attend, reduces operating costs without the need

to prepare a physical venue, and reduces risks of infectious diseases and other health risks by eliminating the need for shareholders, directors, and other members to gather in person. Thus, by amending the Industrial Competitiveness Enhancement Act (which came into force on 16 June 2021), rules concerning a 'shareholders' meeting without a designated location' were established as exceptions to current provisions of the Companies Act, enabling a virtual-only shareholders meeting to be held.

Under this rule, a listed company may provide in its articles of incorporation to the effect that a shareholders' meeting may be held as a shareholders' meeting without a designated location, so long as the company obtains the confirmation of both the Minister of Economy, Trade and Industry and the Minister of Justice. A listed company that has such provisions in its articles of incorporation may hold a virtual-only shareholders' meeting. But in light of the impact of the spread of covid-19, a listed company that has obtained such confirmation will be deemed to have such provisions in its articles of incorporation for a period of two years after the enforcement of the rules (on 16 June 2021). Based on this rule, as at 31 August 2022, 22 listed companies have held virtual-only shareholder meetings and 316 listed companies have resolved at their general shareholder meetings to amend their articles of incorporation to allow them to hold virtual-only shareholder meetings.

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Summary

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GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Most financing transactions in Luxembourg are made by foreign professionals, institutional lenders and banking institutions. Transactions tend, therefore, to be governed by the law that is most familiar to the finance parties, which is generally their domestic law (eg, their law of incorporation). The same generally usually applies to subordination agreements and guarantees. For the latter, it is foreseen that more guarantees will be governed by Luxembourg law in the coming years given the recent Luxembourg reforms on professional payment guarantees. However, contractual agreements relating to Luxembourg assets (share purchase agreements and agreements relating to a Luxembourg security package such as pledge agreements) are governed by Luxembourg law.

Luxembourg law is very liberal and expressly states the principle of freedom of contract, including the choice of law and election of forum (1123 and 1134, paragraph 1 of the Civil Code indirectly). Freedom of contract is, however, limited by mandatory rules and rules of public policy (article 6 of the Civil Code).

The principle *jura novit curia* does not apply to foreign law. The judge does not automatically raise the conflict of laws rule, which is not mandatory in contractual matters. He or she will apply the conflict of law rule when the parties have not opted for a governing law. The parties invoking the foreign law must prove the content of the foreign law, which, for the Luxembourg courts, is a matter of fact.

Choice of law

Luxembourg courts will uphold the choice of law made by the parties to the transaction agreements. However, Luxembourg courts may exclude application of a provision of the law chosen by the parties if, and to the extent that, the result of that application would be manifestly incompatible with fundamental principles of public policy of the Luxembourg forum or they are required to take into account overriding mandatory provisions of a law.

Rules of choice of law for countries of the European Union (EU) are determined by Regulation (EC) No. 593/2008 (Rome I) on the law applicable to contractual obligations. Where there has been no choice of law, the applicable law will be determined in accordance with the rule specified for the particular type of contract. Where the contract cannot be categorised as being one of the specified types or where its elements fall within more than one of the specified types, it should be governed by the law of the country where the party required to

effect the characteristic performance of the contract has its habitual residence. In the case of a contract consisting of a bundle of rights and obligations capable of being categorised as falling within more than one of the specified types of contract, the characteristic performance of the contract will be determined with regard to its centre of gravity.

In the absence of choice, where the applicable law cannot be determined either on the basis of the fact that the contract can be categorised as one of the specified types, or as being the law of the country of habitual residence of the party required to effect the characteristic performance of the contract, the contract should be governed by the law of the country with which it is most closely connected. To determine that country, account will be taken, inter alia, of whether the contract in question has a very close relationship with another contract or contracts.

Enforceability of a judgment

When a judgment has been rendered in a non-EU member state and if no international treaty applies, that judgment will be recognised and enforced in Luxembourg after a review by the Luxembourg Court of First Instance that the conditions set out in article 678 of the Luxembourg New Code of Civil Procedure are fulfilled (ie, the usual conditions relating to public policy constraints, the observance by the court of the rights of defence, etc).

When the judgment has been rendered in any EU member state, except Denmark, Regulation (EU) No. 1215/2012 of 12 December 2012 (the Brussels Ibis Regulation) shall apply if the legal proceeding has been instituted on or after 10 January 2015 (article 66). Similar provisions are provided by the Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters signed in Lugano on 30 October 2007 between the EU member states and three European Free Trade Association countries: Iceland, Norway and Switzerland. The Brussels Ibis Regulation provides that a judgment delivered in an EU member state, which is enforceable in that member state, shall be enforceable in any other member state without any declaration of enforceability being required (article 39). Pursuant to article 42(1) of the Brussels Ibis Regulation, a party that wishes to enforce a judgment delivered in another member state shall provide the competent enforcement authority with:

- a copy of the judgment that satisfies the conditions necessary to establish its authenticity; and
- a certificate issued by the court of origin in the form provided in Annex I of this regulation.

Notwithstanding the above, the Brussels Ibis Regulation still provides for grounds to refuse enforcement of a judgment (article 46 et seq of the Brussels Ibis Regulation). These grounds are the same as those for the refusal of recognition of a judgment (article 45 of the Brussels Ibis Regulation):

- if the enforcement is manifestly contrary to the public policy of Luxembourg;
- where the judgment was delivered in default of appearance, if the defendant was not served with the document that instituted the proceedings or with an equivalent document in sufficient time and in such a way as to enable him or her to arrange for their defence;
- if the judgment is irreconcilable with a judgment given between the same parties in Luxembourg;

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- if the judgment is irreconcilable with an earlier judgment given in another member state or in a third state involving the same cause of action and between the same parties, provided that the earlier judgment fulfils the conditions necessary for its recognition in Luxembourg; or
- if the judgment conflicts with the rules governing the jurisdiction when the policyholder, the insured, a beneficiary of the insurance contract, the injured party, the consumer or the employee was the defendant (articles 10 to 23 of the Brussels Ibis Regulation), and the rules governing the exclusive jurisdiction (article 24 of the same).

Further, Regulation (EC) No. 805/2004 of 21 April 2004 (as amended), creating a European enforcement order for uncontested claims, provides for the abolition of exequatur for judgments on uncontested claims.

A judgment that has been certified as a European enforcement order in another EU member state, other than Denmark, will be recognised and enforced in Luxembourg without the need for a declaration of enforceability and without any possibility of opposing its recognition.

On 1 January 2021, the United Kingdom (UK) left the EU. At this time, and unlike in relation to the judicial cooperation in criminal matters, the UK and the EU have not been able to reach an agreement on the judicial cooperation in civil and commercial matters. Hence, as of 1 January 2021, the Brussels Ibis Regulation can no longer be applied to the UK. The UK applied to re-join the Lugano Convention on 8 April 2020, but the EU opposed on 4 May 2021 the UK's application, stating that the Lugano Convention was intended only for EU member states and European Free Trade Association countries.

On 28 September 2020, the UK acceded unilaterally to the Hague Convention of 30 June 2005 on Choice of Court Agreements. This Convention is now applicable to the UK, Mexico, Montenegro, Singapore and the EU member states except Denmark. This Convention has a procedure similar to the Brussels Ibis Regulation and Lugano Conventions on the choice of forum and recognition by a member of a judgment given by the court of another member. However, this convention does not apply in the case of an asymmetric choice of forum clause. In such a case, to recognise a judgment in Luxembourg the Luxembourg Court of First Instance will verify that the conditions set out in article 678 of the Luxembourg Code of Civil Procedure are fulfilled (as for a ruling rendered in New York).

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

There are no restrictions under Luxembourg law on acquisitions made by foreign entities.

EU credit institutions can provide credit through either a branch or in accordance with rules relating to freedom of provision of services as long as this activity is regulated by the regulatory authorities of their home country (ie, through the application of the EU passport). Hence, the exercise of this activity on Luxembourg territory is not subject to authorisation by the Luxembourg financial sector supervisory commission.

Non-EU credit institutions may also provide cross-border lending to Luxembourg to the extent that Luxembourg credit institutions benefit from such authorisation from the non-EU credit institutions' financial authority. This market access is, however, based on the principle of equivalence (ie, the regulatory esteem that the relevant foreign countries have regulatory regimes that are 'equivalent' in outcome).

Unregulated entities may also provide credit to Luxembourg entities without obtaining an authorisation from the Luxembourg financial regulator (CSSF) as long as their activity does not qualify as lending activity directed to 'the public'; namely, the loan is granted exclusively to a limited circle of previously determined persons or the granting of loan does not fall below an amount of €3 million and the loan is granted exclusively to professionals within the meaning of the Luxembourg Consumer Code.

Intra-group financing is not subject to regulatory supervision.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Large acquisition financing in Luxembourg mainly consists of debt and equity-tainted debt instruments (including hybrid debt instruments such as preferred equity certificates, convertible preferred equity certificates, convertible and redeemable bonds), bank loans (straight loans, syndicated loans, etc) and mezzanine loans (by shareholders or other junior lenders). Almost all financing transactions include senior debt (for the largest amount) and junior debt (provided by shareholders, sponsors or other banks). Luxembourg is particularly attractive for setting up acquisition special purpose vehicles (SPVs), to the extent that its regulatory environment offers to investors a wide panel of financing and debt instruments endowed with features likely to leverage and optimise the tax efficiency of the acquisition transactions. A sizeable number of international and EU acquisitions are channelled through Luxembourg to benefit from this large panel of those economically attractive financial instruments.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

Takeover bids are governed by the Law dated 19 May 2006 on takeover bids (as amended), implementing Directive 2004/25/EC on takeover bids into Luxembourg law. Pursuant to this law, an offeror must announce a bid only after ensuring that he or she can fulfil in full any cash consideration, if it is offered, and after taking all reasonable measures to secure the implementation of any other type of consideration.

Preconditions to the bid are not permitted unless they involve official authorisations or regulatory clearances relating to the bid. This entails that the bid must not normally be made

subject to any financing conditions or preconditions (other than regulatory clearances), and that certain funds must be available to implement the bid.

There is no concept of 'certain funds' in Luxembourg law and regulations. However, many Anglo-Saxon private equity funds are active in Luxembourg and they tend to adopt the City Code 'certain funds' requirement in private treaty transactions. Although not legislatively mandated in this context, and so more flexible, it tends to be enforced to the point where the vendor's counsel will carefully scrutinise the bidder's debt funding term sheets for hidden 'outs'. However, this is not a fixed concept and there is plenty of scope to negotiate the important details. In general, critical finance conditions are negotiated and resolved in the early stages of the bid process.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

There are no legal restrictions on the borrower's use of proceeds from loans or debt securities. However, general prohibition of financial assistance may impose restrictions to the extent that advancing funds or granting loans with a view to providing financial means to enable a third party to purchase existing shares of a public limited liability company (*sociétéanonyme*), European Company (*société européenne*) or a corporate partnership limited by shares (*société en commandite par action*) is prohibited. The prohibition has been somewhat relaxed through a whitewash procedure, but it still stands. Any funding made for purposes of illegal activities is of course prohibited and the borrower must use the proceeds of the loan or debts securities in accordance with the terms of the contract.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

In principle, there are no licensing requirements for EU entities providing financing to a company organised under the laws of Luxembourg. European rules of freedom to provide services, freedom of capital and freedom of movement will prevail. The law also allows for free branching and freedom to provide services that allow all credit institutions authorised and supervised by the competent authorities of another EU member state (home country) to exercise their activities in Luxembourg (host country) as long as these activities are covered by the authorisation of the home country. Non-EU financing institutions may also lend to Luxembourg companies as long as they are regulated and supervised by their home regulator pursuant to terms and conditions that are deemed equivalent, by the Luxembourg regulatory authorities, to those prevailing in Luxembourg for similar financial institutions. Loan origination activities performed by the following undertakings do not require authorisation as professional lenders:

- alternative investment funds;
- securitisation vehicles;
- specialised investment funds;
- pension funds; or
- investment companies in risk capital.

Similarly, financing granted exclusively to a limited circle of previously determined persons or the granting of loan does not fall below an amount of €3 million and the loan is granted exclusively to professionals within the meaning of the Luxembourg Consumer Code and intragroup lending do not require and authorisation form the CSSF. In a broader sense, any type of funding can be freely granted to Luxembourg entities as long as it does not qualify as a financial sector activity.

Since 7 August 2020, UCITS may no longer invest in loans. UCITS have been invited to amend their prospectuses by 31 March 2021 and the CSSF requested that all Luxembourg UCITS that had already invested in loans to modify such investments by 31 December 2020.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Luxembourg does not impose any withholding tax on arm's length interest payments. Accordingly, debt instruments are not subject to withholding tax unless they are requalified as dividends or profit-sharing bonds or notes. This absence of withholding tax on interest, in conjunction with the favourable business environment in general, makes Luxembourg the preferred jurisdiction for international acquisition finance transactions. By way of derogation, if the beneficial owner of the bonds is an individual taxpayer residing in Luxembourg, a 20 per cent withholding tax shall apply pursuant to the amended law dated 23 December 2005. However, this withholding tax is definitive and is deemed to replace the income tax, which applies to income interest for Luxembourg residents.

If an investor wants to fund the acquisition as far as possible with debt, the Luxembourg tax law is, in general, very flexible and does not impose any strict debt-to-equity ratios on ordinary taxable companies. Informal limits are, however, applied by the tax authorities for the financing of an acquisition of a subsidiary by intragroup loans. In this situation, the Luxembourg tax authorities generally consider a ratio of 85:15 as being in line with the arm's-length principle, which means that up to 85 per cent of the purchase price of the participations can be financed by intragroup loans. Interest rates of the intragroup loans must be in line with the arm's-length principles in accordance with transfer pricing regulations in Luxembourg.

Any excess interest payments that result from an excess over the above debt-to-equity ratio (or the arm's-length interest or both) would be reclassified as hidden profit distribution, therefore leading to a requalification of interest payments into dividend distribution, which, tax-wise, is subject to a tax rate of 15 per cent that is generally applicable on dividend payments, unless the recipient qualifies for the affiliation privilege in Luxembourg.

The EU anti-tax avoidance package (Directive 2016/1164 of 12 July 2016 (ATAD 1)) and the anti-tax avoidance Directive 2017/952 of 29 May 2017 (ATAD 2) have been implemented in Luxembourg.

Directive ATAD 1 has been transposed in Luxembourg by law dated 21 December 2018 (the ATAD Law). The provisions of the ATAD Law took effect as from 1 January 2019 (except for

certain provisions that apply to accounting years starting on or after 1 January 2020). The ATAD Law introduced into the national legislation (among others) a limitation of interest deductibility of taxpayers' borrowing costs set at 30 per cent of taxable EBITDA (with the de minimis rule allowing the deduction of exceeding borrowing costs up to €3 million in any case). The new rule only affects the deductibility of interest, and does not requalify the interest expense. As a result, where interest is not deductible in application of the new rule, it remains an interest for all tax purposes, including withholding taxes (ie, in principle not subject to withholding tax unless paid to a Luxembourg-resident individual).

ATAD 2 applies fully as from fiscal year 2022. This domestic law consists in neutralising the tax impacts of hybrid mismatches resulting mainly from the use of hybrid financial instruments and hybrid entities involving third party countries.

The next anti-avoidance package, the ATAD 3 directive (Proposal for a council directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU), as the European Commission intends, if adopted by the member states by 30 June 2023, is expected to take effect from 1 January 2024. The proposal introduces new reporting obligations that may result in the denial of tax advantages to EU entities that are deemed to have no or minimal substance. Such qualification may lead to the denial of Double-Tax Treaty benefits, the removal of access to EU directives (such as the Parent-Subsidiary or the Interest Royalty Directives) as well as a re-allocation of taxing rights. It is also worth noting that the ATAD III substance test includes a look-back period of the preceding two tax years, meaning that should the ATAD 3 directive come into effect in 2024, the compliance requirements may be taken into consideration already as of January 2022.

Finally, gross-up provisions are common in lending documentation and the borrower is usually required to gross-up its payment against any withholding tax that would apply on interest payments.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Article 494 of the Luxembourg Penal Code provides that whoever, by exploiting a borrower's weaknesses, obtains a rate exceeding the legal interest rate (annually fixed through a Grand-Ducal Regulation, equal to 8 per cent a year for 2022) can be sentenced to imprisonment for one month to one year and pay fines ranging from €500 to €25,000, or either one of these penalties. Further, if the lender voluntarily abuses the borrower's need or inexperience to achieve an interest rate clearly exceeding the normal rate in respect of the risk coverage of the loan, the judge, at the request of the borrower, can reduce its obligations to repay the loan capital and the payment of interest.

Another rule of public policy forbids the lender to demand interest on interest (prohibition of anatocism). There is a derogation to this prohibition. Pursuant to article 1154 of the Luxembourg Civil Code, contractual compounding of interest is only permitted with respect to interest due and payable for a period of at least one year and where parties have agreed in writing to such compounding.

The principle of freedom of contract is further limited by the general duty of care. Parties should act reasonably and fairly when negotiating, executing and performing a contract. The principle of due care sometimes allows the judge to intervene when a party's negotiating position would result in unreasonable contractual provisions for the other party, including imbalance between the parties' interests.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Bank lenders

Most of the lending agreement will typically follow Anglo-Saxon formats and tend to favour the lenders. The use of standard contractual clauses of the Loan Market Association tends to progressively prevail in the market, with, accordingly, the adoption of lender-oriented or borrower-oriented contractual clauses. Provisions in agreements can indemnify lenders and agents against all liabilities, losses, costs or expenses arising out of the negotiation, execution, delivery, performance, administration or enforcement of the transaction documents, including pursuant to any proceedings or in connection with the borrower's use of proceeds of such financing. Indemnities typically cover reasonable fees and expenses of legal counsel but are sometimes limited to one principal legal counsel for all such parties and one local counsel in each relevant jurisdiction. Lenders and agents are generally not indemnified to the extent that any such losses or liabilities are caused by their own gross negligence, bad faith or wilful misconduct (and, sometimes, if caused by a material breach by them of the loan agreement) and many contracts will provide that such finding must be made in a final and non-appealable determination by a court of competent jurisdiction.

Securities holders

Holders of securities initially issued to underwriters or initial purchasers are not indemnified by their issuers, except for taxes for which a 'gross up' is payable. Issuers of securities typically indemnify underwriters and initial purchasers against certain liabilities, including liabilities under securities laws, or agree to contribute to payments that such parties may be required to make in respect of those liabilities. Trustees and collateral agents are typically indemnified by the issuer for any loss, liability, damage, claim or expense incurred by them without negligence or bad faith and wilful misconduct (or such similar provision as the parties may negotiate) on their part arising out of or in connection with the administration of the indenture or collateral documents under which the securities are governed and their duties thereunder.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

Debts (including claims for interest) may be assigned by a creditor to a third party without the consent of the debtor. However, restrictions on assignments may be contractually imposed and negotiated in the credit documentation.

For the assignment to be effective towards the debtor and third parties other than the assignee, the debtor must be notified of the assignment (by letter or by the service of a bailiff) or must assent to the assignment (by private deed or notarised deed).

Requirements to act as agent or trustee

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

There are no specific regulations governing whether an entity can act as an administrative agent for bank financing.

The Law of 10 August 1915 on Commercial Companies, as amended (the Company Law) provides the appointment of a fiduciary agent (to some extent equivalent to a trustee) in certain types of companies, such as public companies limited by shares (*société anonyme*) that have issued bonds. Such a trustee will act as representative of the bondholders and undertake certain responsibilities set out in the law.

The Law of 22 March 2004 on Securitisation Companies also provides for the appointment of a fiduciary agent under certain conditions, in particular when the securitisation operation is structured as a transparent fund.

Luxembourg has adopted the Law of 27 July 2003 on Trusts and Fiduciary Agreements (the Law of 27 July 2003), ratifying the Hague Convention of 1985 relating to the Law Applicable to the Trust and its Recognition. Although it is not possible to create a trust in the Anglo-Saxon sense in Luxembourg, trusts governed by foreign law are recognised in Luxembourg to the extent that they are authorised by the law of the jurisdiction in which they are created.

The adoption of the Law of 27 July 2003 also introduced in Luxembourg a specific regime equivalent to the trust institution, known as the fiduciary agreement. The undertaking of the role of fiduciary agent is, however, limited to financial institutions and certain professionals of the financial sector. A fiduciary agreement can be easily implemented (there are no registration or publication requirements) and is effective towards third parties upon its execution, without further notification requirements. An assignment of debt to a trust is enforceable against third parties upon its execution.

Finally, article 2(4) of the Law of 5 August 2005 on financial collateral arrangements as amended (the Financial Collateral Law) provides that collateral may be provided in favour of a person acting for the account of the beneficiaries of the collateral, a fiduciary or a trustee, to secure the claims of third-party beneficiaries, present or future, provided such third-party beneficiaries are determined or determinable. Without prejudice to their duties towards the third-party beneficiaries of the financial collateral arrangements, the persons acting for the account of the beneficiaries of the financial collateral, the fiduciary or the trustee, enjoy the same rights as those granted to direct beneficiaries of the financial collateral referred to under this law. The recent amendment made to the Financial Collateral Law provides that a transfer of title for security purposes can also be granted to a person acting on behalf of the beneficiaries (eg, a security agent, a fiduciary or a trustee).

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

A borrower may, from time to time, proceed to the buy-back of debts. However, although legal provisions regulate and organise the redemption of shares, no legal provisions govern debt buy-back. Buy-backs are a matter of contractual negotiations. Junior and senior debt have been heavily bought back in recent years, with the view to benefit from discounted values in a distressed environment.

There is some variation in buy-back provisions but the most typical formulations in large global transactions with sophisticated investors permit purchases by both the borrower and a sponsor, subject to ensuring equal treatment between debtors and transparent information to all investors.

Securities financings

There are many alternatives for an issuer to repurchase its securities, including privately negotiated transactions, open market purchases, cash tender offers and exchange offers. Sponsors may purchase securities, but, under the indenture, affiliates are typically not permitted to vote debt securities owned by them.

Exit consents

13 | Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Yes. In this matter, as in others, the freedom of contract prevails. Modification of contractual provisions will generally require obtaining the consent of a majority of lenders in the context of securities financing. Such consent solicitations may enable a company to remove or relax covenants or events of default (either in respect of a particular contemplated transaction or permanently), which, if approved, will be binding on all holders regardless of whether they consent or not. Consent solicitations can be conducted either alone or jointly with a tender offer (ie, holders deliver their exit consent).

Provisions authorised to be amended are generally strictly listed. The majority ratio necessary to obtain a consent can be fixed either in value (percentage of total loan) or in number of lenders (percentage of number of lenders out of total number of lenders) or both criteria. In addition, under the terms of most loan agreements, certain provisions require the consent of a greater percentage of lenders, each lender or each affected lender. However, agreed changes amending the securities' features should not be so substantial as to affect the nature of the securities and trigger adverse tax effects on the Luxembourg SPVs.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no particular taxes, costs or liabilities charges over a guarantee. No stamp duty or similar tax or charge applies to the creation or enforcement of a specific pledge security interest over movable assets, such as shares, bank accounts or receivables; nor are there any public registration requirements. The guarantee between related companies is, however, a related-party transaction from a Luxembourg direct tax perspective. As such, the related company guarantee must be compliant with Luxembourg transfer pricing legislation. On a case-by-case basis, it may also be necessary, considering all the facts and circumstances, to assess whether the guarantee satisfies the corporate interest test or should be remunerated by an arm's-length remuneration.

In cross-border financing transactions, Luxembourg companies are often located in the upper part of the group structure and are required to provide security interests over their assets or provide guarantees in relation to the obligations of their (in)direct subsidiaries, or both. From time to time, Luxembourg companies are involved in cross-collateralised transactions involving the granting of guarantees also for the obligations of their parent company or sister companies. In such situations, the ultimate corporate benefit of the grantor must be carefully scrutinised to ensure full enforcement of the guarantee.

There may be limitations where cross-group guarantees or upstream guarantees are being granted. Luxembourg does not recognise the concept of a 'group of companies' and the interest of the corporate group is insufficient to justify and validate an upstream guarantee. Corporate benefit must be scrutinised on a case-by-case basis: the guarantor should have some personal interest in the guarantee, notably through its expected benefits, and the risks it may take should be commensurate with the benefit deriving therefrom. In addition, the financial exposure deriving from the guarantees should not exceed the financial means of the guarantor at the moment of granting the guarantee. In practice, guarantors under cross-group guarantees tend to limit, however disputable, the contractual recourse to a certain percentage of the net asset (book) value of the grantor. If, at all, a limitation of a guarantee is to be included in the loan documentation, such a guarantee should be based on the real value (and not the book value) of the assets, disregarding the then outstanding liabilities.

There is no legal or regulatory restriction applying to foreign-registered related companies to provide guarantees in Luxembourg or under Luxembourg law.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

As a general principle, it is unlawful for a company incorporated in the form of a public limited liability company (*sociétéanonyme*), European company (*société européenne*) or a corporate partnership limited by shares (*société en commandite par action*) to provide financial assistance for the acquisition of its own shares by a third party (subject to certain exceptions). Luxembourg law does not elaborate further on what constitutes prohibited financial assistance. Article 430-19 of the Company Law provides that such company may not directly or indirectly advance funds, grant loans or provide security with a view to the acquisition of its own shares by a third party.

There are several limited exceptions to the general prohibition. For example, it does not apply to transactions undertaken as part of banks' and other finance professionals' usual business, nor to transactions in which the shares are acquired by or for employees of the target.

A breach of the financial assistance prohibition may result in civil and criminal liability for the target's directors. Third-party lenders may face civil liability and the transaction may be annulled.

Since 10 June 2009, a whitewash procedure has been introduced into the law intended to facilitate the restructuring of the shareholding of those entities, while still protecting the interests of minority shareholders and creditors. Financial assistance is allowed provided the company complies with the 'whitewash procedure', which requires, inter alia, that the transaction be carried out at fair market conditions, the company have distributable reserves in the amount of the financial assistance granted, and the transaction be approved by the shareholders, subject to a detailed published management report on the transaction.

There used to be a debate among scholars in Luxembourg on whether the prohibition of financial assistance applied also to Luxembourg private limited liability companies (*sociétés à responsabilité limitée*). The Luxembourg law of 6 August 2021 settled the debate on confirming that such prohibition does not apply to private limited liability companies (*sociétés à responsabilité limitée*).

Article 430-20 of the Company Law provides for special rules that apply where there is a conflict of interest between the parties involved in the purchase of the shares and those in charge or involved in the whitewash procedure.

Given the fact that the level of net assets of a Luxembourg holding company or SPV is generally low, the effect of the whitewash procedure is rather reduced considering that the company needs to allocate from its profits an amount of non-distributable reserves at least equal to the value of the financial assistance granted.

There may also be limitations where cross-group or upstream guarantees by subsidiaries of the borrower are being granted. Lacking a definition of 'group of companies' in Luxembourg law whereby the interests of the group could override those of a single company, the validity

of cross-stream or upstream guarantees will ultimately depend on a corporate benefit analysis by the grantor. In particular, the guarantor should have some individual interest (consideration) in the transaction and the expected benefit deriving from the guarantee should outweigh the risks taken in granting the cross-stream or upstream guarantee. The financial liability resulting from a guarantee should not exceed the financial capacity of the guarantor and, more specifically, should not put the guarantor into an insolvent position. In practice, this may often give rise to contractual limitations of recourse, however disputable, under cross-group guarantees to a certain percentage of the net asset value of the grantor.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Security interests available under Luxembourg law can be divided into:

- securities over immovable assets, which include mortgage over land, building and vessels; and
- securities over movable assets, which include:
- securities over financial instruments (pledge over shares, claims, bank accounts, debt instruments, assignment of title by way of security), which are governed by the Financial Collateral Law;
- pledges over goods or tangible assets that are not financial instruments;
- pledges over business assets, which is a general security covering the value of a company's intangible assets (eg, clientele, business model, trademark, patents, lease rights, etc and up to 50 per cent of the stock of the company), which can only be granted to banks, credit institutions and breweries being accredited by the Luxembourg Ministry of Finance;
- preservation of title on tangible assets; and
- retention rights under a sale or warehouse contract.

Luxembourg law also provides for specific guarantees such as personal, independent or joint guarantees or even partial assignment of salary in favour of a creditor.

Luxembourg law does not provide for the creation of fixed and floating charges. It is, however, often the case in international transactions that a Luxembourg company grants a fixed or floating charge governed by foreign law.

It is possible to grant a security on all future movable assets of the debtor (not on future immovable assets), but the 'blanket lien' does not exist under Luxembourg law.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Under Luxembourg law, the transfer of the possession (dispossession) of the assets over which the pledge is granted is a condition to the constitution of the pledge. Such dispossession can be done in various ways depending on the type of assets to be pledged. Dispossession is also required to make the pledge enforceable against third parties. The law of the pledgor's jurisdiction may impose further perfection or notification requirements.

The dispossession of registered financial instruments whose transfer takes place by a transfer in the registers of the issuer (as this is the case with respect to the shares in public company limited by shares) may be established by recording the pledge in those registers.

A pledge created over shares in a private limited liability company (*société à responsabilité limitée*) must be notified to the company whose shares are pledged. Unless the debtor whose claims are pledged is party to the pledge agreement, such a pledge agreement must be notified to, or acknowledged by, the debtor. Lacking such notification, the debtor of a pledged claim may validly discharge his or her obligation to the pledgor as long as he or she has no knowledge of the mere conclusion of the pledge.

A pledge over bank accounts must be notified to the account bank maintaining the accounts. It must be further acknowledged by the account bank to ensure that a valid first ranking pledge is granted over the accounts.

A security interest granted over immovable assets (mortgage) or business assets must be registered with the local mortgage registration office.

Failure to comply with these provisions could jeopardise the enforceability of the security interest and its ranking towards third parties and other creditors.

The perfection of security interests over immovable assets (mortgage) or business assets must be registered with the local mortgage registration office.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Luxembourg security interests are accessory in nature and continue to exist as long as the principal claim they secure is in place; hence, no renewal procedure is required. However, by derogation, a pledge over business assets and a mortgage over immovable properties are only valid for a duration of 10 years (but are renewable).

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

No. 'Works council' consent is not required.

It is recommended to ensure that the granting of guarantees and securities be approved by the grantor itself (ie, its board or relevant authorised corporate body) with a view to assessing and ascertaining that the granting of guarantees or security satisfies the corporate interest of the grantor and any conflict of interest be cleared.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

The Financial Collateral Law specifically provides that a security over financial instruments can be granted to an agent or a trustee acting for itself and for the benefit of all lenders, to secure the claims of third-party beneficiaries, present or future, provided the third-party beneficiaries are determined or determinable.

For other types of securities (including fiduciary arrangements), the effect of the agency provisions (whether governed by Luxembourg or foreign laws) will be recognised and enforceable in Luxembourg. It is, however, recommended to specify the capacity in which the security beneficiary is acting in the relevant security agreement. For all security interests that fall outside the scope of the Financial Collateral Law and where such security is granted to an agent or a trustee, parallel debt provisions will need to be put in place in the loan documentation.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

In general, the circumstances under which collateral may be released are specified in the security agreement or the credit agreement, where applicable. By nature, accessory collateral (eg, pledges or sureties) ceases to exist when the secured obligations have been satisfied in full. In this respect, collateral is generally released only when full discharge of the secured obligations effectively occurs. To the extent that the relevant provision does not permit the automatic release of collateral, the consent of the lenders or holders will be required to release the collateral according to the contractual negotiated terms.

Before the release or lapse of security, the secured party may enforce its rights either through judicial enforcement or, in the case of pledges, realise the security without any court action pursuant to the Collateral Law by collecting pledged receivables or dividends, or appropriating the pledged shares or securities at a determined valuation or cause them to be sold through either a public auction or a private sale.

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Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

Under Luxembourg bankruptcy law, the incurring of debt or the granting of a security interest as collateral in connection with it could be voided under certain conditions, as set out in the Company Law, in the Luxembourg Commercial Code and in the Civil Code.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

In most cases, debt commitments are governed by foreign laws. Legal techniques and the sequence of documentation prevailing in Anglo-Saxon legal practices are customarily used in Luxembourg. There is, therefore, no standard practice in Luxembourg, and the full set of documents would be familiar to Anglo-Saxon investors.

In the initial steps towards the transaction, acquisition finance documents will usually include a letter of intent, a commitment letter issued by the bank or financing parties, or both, a term-sheet, a fee letter and, to the extent a capital markets transaction is involved in the acquisition financing, an engagement letter and often a fee credit letter.

The closing documentation will typically include a credit facility agreement, with the financing banks or loan agreements with financing parties, whether subordinated or not, and various finance documents that would comprise a 'security package' including:

- pledge over receivables;
- pledge over shares;
- pledges over bank accounts and other charges on movable and immovable assets with forms of all required notices to be sent under the security documents;
- any hedging arrangements;
- subordination agreements and intercreditor agreements;
- equity documents; and
- utilisation requests.

English concepts of debenture are not used in Luxembourg in as much as this type of general security is unlikely to be enforceable under Luxembourg law.

Apart from the commitment letter and letter of intent, the documentation is contemporaneously signed on the day of the closing of the acquisition. Signing in counterparts has now become a common practice in Luxembourg and exchange of executed documentation by fax and electronic copy (with originals to be provided later on) is validly recognised. Luxembourg law requires, however, that the same number of original agreements be signed as the number of involved parties having distinct interests to the agreements of the transaction.

This rule does not apply to contracts signed by way of electronic signatures that are increasingly being used in acquisition financing transactions.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Best efforts commitments remain unusual. Transactions are generally carried out in Luxembourg when the acquisition deal has been secured through fully underwritten commitments in connection with acquisition financing. Luxembourg, being mainly an acquisition platform for its unrivalled features, such as secured creditor-friendly jurisdiction, ease of public quotation, pragmatic contractual enforcement and absence of withholding tax on interests payments, is the 'last stage jurisdiction' when the deal is nearly completed and all financing details have been already resolved. Because closing occurs when financing is secured, it is unusual to negotiate a transaction in Luxembourg whose financing remains uncertain. Good faith in negotiations also remains a requirement and any negotiator may be liable in tort if he or she acted in bad faith in the pre-contractual phase of negotiations without any intent to commit him or herself.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The conditions precedent list may have a variable perimeter according to the bargaining power and existing trust between parties. Some of the more frequent typical conditions are:

- satisfactory completion of due diligence: legal and financing (including audited and unaudited financial statements and of pro forma financial statements);
- review of good standing of a corporate borrower;
- report on title (real estate);
- tax clearance on the acquisition structure and structure memorandum;
- corporate conditions precedent: existence, authorisation, capacity to enter into the contractual documentation including directors or managers' certificates, solvency certificates issued by the directors or managers of the Luxembourg obligors and the delivery of excerpts and negative certificates (absence of registered insolvency proceedings) from the Luxembourg trade and companies registry relating to the Luxembourg obligors on or around the date of the credit agreement;
- funds-flow statement;
- legal opinions from counsel on borrower or target, or both;
- no business material adverse change;
- consummation of the acquisition pursuant to the acquisition agreement;
- completion of marketing period and receipt of customary syndication or disclosure information;
- execution and delivery of documentation;
- perfection of security interests;
- delivery of an offering document suitable for marketing any securities;

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- payment of fees; and
- receipt of know-your-customer and anti-money laundering rules and regulations.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Luxembourg banking and financial institutions are not geared towards large financing or syndications. In addition, they tend to focus their strategy more on private banking activities than on investment banking or commercial credit. Most of the financing operations are carried out by European branches of US or UK banks, or UK branches of French or German financial institutions. Each of them tends to deal according to their national market practices, Luxembourg offering only the investment vehicle to lodge the syndicated financing.

The covid-19 pandemic has increased the risk for underwriters, who are now adopting increased protection, which can translate into more significant flex provisions in a more cautious or restrictive lending environment. Terms are being 'flexed' by arrangers and underwriters to mitigate such a risk, for example by avoiding taking on financing commitments at pricing that does not reflect the business risk affected by covid-19.

The 'classic' terms that are made subject to market flex are those that deal with margin and arrangement fees. Structural flex is also common, particularly on transactions with multiple tiers of secured debt. This involves the rights to reallocate the debt among tranches or to allocate a portion of the committed amount to newly created tranches or subordinated facilities according to market demand, in particular for more seniority in the capital structure. In addition, financings include pricing flex at levels substantially higher than expected market-clearing prices and impose additional adjustments for changes in market indices.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Arrangers have the right to require the borrower to replace the bridge loan with a permanent financing package. Bridge financing would ordinarily finance initial capital expenditure investments.

Bridge financing can frequently be secured by the issuance of free warrants entitled to acquire equity interests or other debt-equity instruments.

The terms and conditions of the securities would usually be those prevailing in the markets in which the syndicated banks compete for financing. Terms of securities would be negotiated on a case-by-case basis and include various features such as secured against unsecured, quoted or non-quoted with a maximum number of demands for securities with a minimum issuance amount for each call. Financing conditions would also set the weighted average yield for all securities to be issued irrespective of their tranches and time of issuance.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Foreign acquirers or lenders want to know that most of the contractual provisions protecting their rights, subject to foreign law, will be fully enforceable in Luxembourg against the Luxembourg special purpose vehicle (SPV). Much care would be addressed to representations relating to valid corporate authority and the binding effects of the contractual agreements. Lenders will rely heavily on local counsel to obtain confirmation, under a formal legal opinion, of the validity and compatibility of contractual provisions with Luxembourg law: the validity and enforceability of a non-recourse clause, upstream guarantee or subordination provisions will be heavily scrutinised and security packages would be fiercely negotiated. In particular, provisions entitling the enforcement of loan agreements in distressed situations would be key in the Luxembourg negotiations, with a view to enabling lenders to recover their investments in insolvency situations.

In addition, lenders will be sensitive to any tax frictions that the use of a Luxembourg SPV could generate. Specific representations and covenants will be negotiated to this effect and assurance that the tax treatment of the financing and acquisition operations has been secured remains paramount.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

No filing requirements apply to commitment letters, and acquisition agreements remain private and are protected by the law on privacy.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Luxembourg is known as one of the best business places in the world to enforce collateral. Luxembourg's business law is very flexible in this respect and the Financial Collateral Law has brought additional protection for enforcement of collateral over financial instruments.

Securities subject to the Financial Collateral Law and real securities (eg, mortgages) are not affected by the insolvency of the debtor and may be enforced in spite of the filing of a petition for bankruptcy or other collective proceeding, whether occurring in Luxembourg or abroad.

Contracts in going concerns are not automatically terminated by the effect of a bankruptcy of the debtor (except for employment contracts). However, contracts that may not be continued during the insolvent period usually terminate. All interest accruals stop from the date on which the bankruptcy has been declared, except when the debt is subject to a security.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

There is no equivalent concept under Luxembourg law.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

Upon the declaration of bankruptcy of a company, an automatic stay arises, prohibiting the collection of claims against the bankrupt entity. Secured creditors benefiting from certain types of securities (eg, pledge or mortgage) may, however, enforce their rights under certain conditions. Creditors benefiting from a security on financial instruments are never prevented from enforcing their rights, provided the security was created before the opening of the bankruptcy.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

Transactions can only be clawed back or challenged in a bankruptcy. A clawback is initiated by the receiver and debated in court. Only specific transactions can be challenged.

Transactions entered into during the hardening period (fixed by the judge, which may not be longer than six months before the court order declaring the bankruptcy) may be declared invalid if they constitute the preferential satisfaction of one creditor over another.

The rights of creditors benefiting from a security governed by the Financial Collateral Law, even granted during the hardening period, are not affected by a bankruptcy or reorganisation proceedings and therefore remain enforceable.

The court can cancel the following transactions:

- disposals of assets without adequate consideration;
- payments made for debts not yet due;
- payments of due debts by means other than cash or bills of exchange; and
- granting of any security for a debt contracted before the hardening period.

Any payment for accrued debt or any transactions against money made after a company has ceased its payments and before the bankruptcy judgment may be cancelled by the court if the beneficiary of the payment or the contracting party was aware of the debtor's cessation of payments.

Mortgages granted during the hardening period (or 10 days before) may be cancelled if their registration was not carried out within 15 days of conclusion of the mortgage deed.

As a general principle, payments made fraudulently and without regard to the creditors' rights are void, irrespective of the day on which they were made.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Secured creditors benefiting from valid securities are entitled to payment prior to unsecured creditors. The law provides for a 'waterfall' or ranking for the payment of certain claims owed to privileged creditors.

The ranking set out by law is as follows:

- judicial expenses costs, including the fees of the trustee or receiver appointed by the court;
- compensation for victims of an accident and funeral costs;
- unpaid wages or salaries of employees of the insolvent company;
- tax and social security claims;
- specific privileges on movable assets (as opposed to general privileges, specific privileges can only be enforced on specific assets of the debtor: for example, rents can be secured by the furniture of the rented premises);
- general privileges on movable and immovable assets (which can be enforced on all of the assets belonging to the debtor);
- specific privileges on immovable assets (which can only be enforced on specific assets, such as the seller's lien or the lender's lien, whose rights can solely be secured by the immovable asset purchased by the debtor);
- mortgages;
- pledges; and
- unsecured creditors.

Thereafter, rank the contractually or statutorily subordinated debt claims and finally the share equity interests. The ranking of the subordinated creditors depends on the respective ranking contractually agreed.

Within each category of securities, the ranking of creditors generally follows the rule *prior tempore, potior jure* and is determined as follows:

- mortgage: if the borrower becomes insolvent, the lenders are repaid in the order of the respective mortgage registration;

- seller's lien: if there has been more than one sale of property to the borrower subject to seller's liens, the first seller is paid first, the second seller is paid second and so on;
- privileges: these interests (such as a seller's lien) grant priority to the creditors, even against creditors with a registered mortgage; and
- pledge: if there is more than one pledge over the same assets, the date on which it was made effective towards third parties (eg, registration or notification, as the case may be) determines their ranking.

For a plan of reorganisation (controlled management) to be approved, the creditors must vote in favour of the plan by a majority of the creditors representing more than half of the company's claims. Once approved, the plan is effective towards all the creditors.

Security interests granted to creditors over financial instruments or claims under the Financial Collateral Law remain enforceable despite the opening of a bankruptcy or reorganisation proceedings.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Under Luxembourg law, no legal provision exists preventing creditors from agreeing on the rank of their claims. Case law and Luxembourg legal scholars recognise the validity of contractual subordination arrangements. Such agreements are effective towards third parties and courts would normally enforce them.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

All interest accruals stop from the date on which the bankruptcy was declared, except when the debt is subject to a security. The discount on securities corresponds to unaccrued and unmatured interest on the date the bankruptcy is declared by court ruling.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

Generally, a secured creditor that forecloses on collateral takes the collateral 'as it is' with any potential liabilities against which the collateral is subject. This is particularly the case in the event of appropriation and realisation of the assets subject to the security. The security being customarily in rem, all liabilities follow the collateral.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

The Luxembourg government introduced on 15 September 2021 a new bill of law No. 7885 (Bill 7885) to establish a national screening mechanism for foreign direct investments likely to affect security or public order. This bill aims at implementing EU Regulation 2019/452 establishing the screening of foreign direct investments in the European Union.

Bill 7885 concerns investors outside the European Union, Iceland, Liechtenstein and Norway willing to invest in a Luxembourg company conducting activities in various sectors being regarded as critical or strategic importance in Luxembourg which could affect security or public order (sectors such as energy, transport, water supply, health, communication, data storage, aerospace, defence, finance, media).

Bill 7885 provides for a prior notification regime with screening procedure and enforcement or sanction measures in case the prior notification or the screening procedure is not respected by the foreign investors (fines can go up to €5 million). Prior to investing in Luxembourg companies, a foreign investor would need to carefully assess whether it falls within the investment subject to Bill 7885.

Bill 7885 should have been adopted in the course of 2022. However, on 22 March 2022, the Luxembourg Council of State (Conseil d'Etat) issued an opinion with several formal objections to the Bill.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

In Mexico, transaction agreements are typically governed by the Code of Commerce, which sets forth the general rules for transaction agreements, as well as procedural rules for commercial disputes. Nonetheless, depending on the particular transaction, a specific commercial law may be applicable (eg, the General Law of Negotiable Instruments and Credit Operations for credit transactions).

Mexican courts may recognise the choice of foreign law, provided that certain specific rules are met, and that the choice of such foreign law is not used to evade fundamental principles of Mexican law, or the result of its application does not contravene the principles of Mexican law.

Judgments rendered by a court of a foreign jurisdiction may be recognised by Mexican courts and are enforceable in Mexico, provided that certain requirements are met.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

There are certain activities reserved to Mexican individuals or Mexican corporations that do not admit foreign investors. These activities include domestic land transportation of passengers, tourism and freight; the incorporation of banking institutions; and rendering certain professional and technical services.

Additionally, there are other activities in which the participation of foreign entities is limited, such as manufacture and commercialisation of explosives, firearms, cartridges, ammunition and fireworks; the printing and publication of newspapers; freshwater, coastal and exclusive economic zone fishing; integral port management; port pilot services for inland navigation; commercial exploitation of ships for inland and coastal navigation; radio broadcasting services; and regular and non-scheduled domestic air transport service, non-regular international air transport service in the form of air taxi; and specialist air transport service.

There are other activities that require an authorisation from the Foreign Investments Commission in order for the foreign investment to participate in a percentage above 49 per

cent. These activities include port services to carry out inland navigation; shipping companies engaged in the operation of vessels exclusively in traffic height; aerodromes services; private education services; legal services; and the construction, operation and exploitation of railways, as well as the provision of public rail transport services.

There are no restrictions on engaging in cross-border lending transactions pursuant to Mexican law.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Acquisition financings typically includes senior debt that is collateralised through pledges over fixed assets, and equity instruments, as well as through mortgages. It is customary for lenders to select to structure loans in the form of senior debt, rather than subordinated debt.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

There are no specific rules requiring certainty of financing for companies that are listed on the Mexican stock market.

'Certain funds' provisions are not customary in Mexico and are not market practice. Nonetheless, it is possible to include such provisions in financing documents.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Working capital and fixed asset loans are specifically regulated under the General Law of Negotiable Instruments and Credit Operations, which provides specific restrictions for the use of proceeds from such loans.

On one hand, the proceeds of working capital loans can only be invested in working capital expenses, such as the payment of wages, the acquisition of raw materials or capital expenses related to the performance of business of the company.

Fixed asset loans regulated under the General Law of Negotiable Instruments and Credit Operations are those loans intended to finance the acquisition of fixed assets in the agricultural industry. In terms of the applicable law, the proceeds of this type of loan can only be used to acquire such assets.

Besides the restrictions provided in the General Law of Negotiable Instruments and Credit Operations for working capital and fixed asset loans, there are no statutory restrictions on the borrower's use of proceeds from loans or debt securities. However, the parties of a commercial agreement (including agreements where loans and debt securities are documented) are free to set forth any negative covenants, as long as these covenants do not contravene Mexican law.

In such regard, even though Mexican law does not expressly provide restrictions on the borrower's use of proceeds from loans or debt securities (besides those described before), it is common for lenders to impose certain negative covenants on borrowers with regard to the use of proceeds from loans or debt securities.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

The main financial institutions that operate in the country and provide financing include banks, popular finance companies (SOFIPOs), and multiple purpose financial companies (SOFOMs). To operate as a Bank or SOFIPO, an authorisation from the federal government, through the Mexican Banking and Securities Commission, must be obtained. Likewise, SOFOMs must be registered before the Commission for the Defence of the Users of Financial Services to operate as such.

Foreign financial institutions do not require licensing requirements to provide financing to a company organised in Mexico.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Principal payments related to indebtedness are not subject to withholding tax in Mexico provided the indebtedness is duly documented and that in the corresponding agreement such principal amount is clearly separated from interest to be paid.

However, interest paid by Mexican tax residents to residents abroad as a general rule is subject to income tax withholding. The applicable withholding rates contemplated in the Mexican Income Tax Law vary depending on the nature of the resident abroad who is actually receiving the payment of interest or the transaction itself that gives rise to the obligation to pay interest.

Accordingly, the withholding rates established in the Mexican Income Tax Law range from 4.9 to 40 per cent, as detailed below:

- 4.9 per cent – interest on debt instruments placed abroad or paid to specific foreign financial institutions.
- 10 per cent – interest paid to foreign financing entities, entities that place or invest capital in Mexico with funds arising from securities issued by them publicly traded

abroad among investors at large or foreign banks (including investment banks and limited purpose financing entities), as well as interests derived from securities placed through banks or brokerage houses paid to residents abroad in a country with which Mexico has not in force a double taxation treaty and the acquisition of a credit right of any kind.
- 15 per cent – interest paid to reinsurance entities.
- 21 per cent – interest paid (different to the payments referred to above) by Mexican financial institutions to residents abroad, interest payments made to foreign suppliers for the sale of machinery and equipment (fixed assets of the purchaser) and to residents abroad for the financing granted for the acquisition of such machinery and equipment.
- 35 per cent – other interest paid to other residents abroad not included herein.
- 40 per cent – interest paid to persons, entities that are considered legal entities or transparent for tax purposes or other legal figures created or constituted in accordance with foreign law, whose income is subject to a preferential tax regime (exceptions apply including interest payments made to foreign banks).

Borrowers that are Mexican tax residents are obliged to withhold the corresponding income tax when making interest payments to lenders residing abroad. Borrowers are not obliged to indemnify lenders for such income tax.

The Mexican Income Tax Law also establishes a list of types of interest paid to residents abroad that are exempt from such tax.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Under Mexican law, there are no usury laws or rules that expressly limit the amount of interest that can be charged under a financing agreement.

As a general rule, the parties have contractual freedom to agree the amount of interest that can be charged. Nonetheless, the Supreme Court of Justice of the Nation has interpreted that even though the commercial legislation contemplates the possibility of charging interest on loans, based on the principle of contractual freedom, in accordance with the American Convention on Human Rights, the protection of debtors against abuses and the charging of excessive interest, for constituting usury, must be recognised by the Mexican courts. Thus, the judge hearing a lawsuit where an excessive or disproportionate collection of both ordinary and default interest is appreciated, must act in favour of the debtor, avoiding the excessive collection of the creditor.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Indemnities provided by the borrower to lenders will depend on the type of financing. Nonetheless, it is customary that borrowers provide indemnities related to the use of proceeds from the loan; the performance of their obligations in terms of the financing

agreement, including positive and negative covenants; the accuracy of the representations and warranties stated; litigations brought by third parties, among others.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

Under Mexican law, the assignment of interests among lenders is allowed. Nonetheless, it is customary for financing agreements to include an 'assignment clause' in which the terms and conditions of the assignment of the financing agreement and certain specific rights and obligations are regulated and agreed between the parties.

Requirements to act as agent or trustee

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

There are no rules that govern the administrative or collateral agent in a financing transaction. Under Mexican law, any entity can act as administrative or collateral agent, including lenders. Regarding trustees, Mexican law provides that only specific financial entities can act as trustees in a trust.

Debt buy-backs

12 May a borrower or financial sponsor conduct a debt buy-back?

Pursuant to Mexican law, there are no rules that prohibit a borrower or a financial sponsor from conducting a debt buy-back.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

It is possible to request the majority of lenders to amend the debt agreements to modify any covenants.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no restrictions with regard to guarantees granted by related companies or third parties. With regard to secured guarantees, the perfection of the security interests granted could have associated costs, such as notary public and registration fees.

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Foreign-registered related companies are allowed to provide secured or unsecured guarantees; however, there could be limitations related to the enforcement of such guarantees in a foreign country.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

As such, there are no specific provisions that restrict or limit the target's ability to provide guarantees, collateral, or financial assistance in an acquisition of its shares. To authorise these actions, it is customary for a corporate resolution to be adopted by the shareholders or partners of the relevant target, through which the provision of guarantees, collateral or financial assistance is approved.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Under Mexican law, it is possible to grant security interests over any assets or ownership rights (this includes real estate property, machinery, copyrights, trademarks, negotiable instruments, shares or bonds). Floating and fixed charges are also permitted.

Blanket liens can be granted over all assets, except real estate property, which has specific formalities for perfection.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

The General Law of Negotiable Instruments and Credit Operations regulates two types of security interests that can be granted over movable property as collateral: (1) the pledge with transfer of possession; and (2) the non-possessory pledge. The difference between these two types of pledges is that, when granting a non-possessory pledge, the pledgor retains the possession of the pledged assets, while the pledge with transfer of possession, necessarily requires for the pledgor to transfer the possession of the pledged assets.

To perfect collateral granted through a pledge with transfer of possession, the following requirements must be met: (1) a pledge agreement must be executed in writing; (2) possession of pledged assets must be transferred to pledgee (ie, pledged assets must be delivered or endorsed).

To perfect collateral granted through a non-possessory pledge, the following requirements must be met:

- a non-possessory pledge agreement must be executed in writing;
- when the amount of the credit secured by the pledge is equal to or greater than the equivalent in local currency of 250,000 Investment Units (ie, around US$89,000) the parties must ratify the non-possessory pledge agreement before a Mexican notary public; and
- the non-possessory pledge agreement must be registered in the Registry of Movable Guarantees.

The requirements to perfect a security interest over real estate property granted as collateral are provided in the local Civil Code of the state where the real estate property is located. This generally includes:

- the execution of a mortgage agreement in writing;
- the ratification of the mortgage agreement before a Mexican notary public; and
- the registration of the mortgage before the local Public Registry of Property.

Moreover, it is also common to incorporate a security trust in order to grant collateral for the benefit of the lenders. Security trusts are regulated in the General Law of Negotiable Instruments and Credit Operations. Through this type of trust, the borrower (or any related or third party that grants a security interest) transfers certain assets to a trust with the purpose of securing the borrower's obligations.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

The validity of a security interest will be subject to the term set forth in the relevant security agreement. It is customary for the validity of a security interest to be tied to the term of the principal agreement that sets forth the secured obligations. However, periodical renewal of the registrations of the security before the local registries might be required to keep the security interest recorded and effective against third parties.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

Under Mexican law, other than appropriate corporate governance consents or approvals, no 'works council' consents are required to approve the provision of guarantees or security by a company.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

It is possible to grant security to an agent for the benefit of different lenders instead of granting collateral individually to each lender. However, in this case, it is customary for a security trust to be incorporated.

Under a security trust, a financial institution will act as trustee and will assume the role of collateral agent for the benefit of all the lenders.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Typically, creditor's protection clauses are included in the security agreements (ie, the pledge or mortgage agreements). The parties have contractual freedom to include any restrictions or limitations on the sale of the assets granted as collateral, including prohibitions on selling such assets, or the obligation to request the consent of the creditors to execute any sale.

Additionally, when creditors seek to structure such protection more effectively, a security trust is incorporated. As stated before, when a security trust is incorporated, borrowers transfer the assets granted as collateral to the trust that is incorporated, which will be managed by a financial institution acting as trustee. When structuring a security trust, the parties can include any limitations on the sale of the assets granted as collateral as well, and the trustee is obliged to comply with such limitations.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

The Federal Civil Code and the local codes of each of the States of Mexico protect creditors against the fraudulent transfers that generate the insolvency of debtors. There is a specific claim (*acción pauliana*) that creditors can file before a Mexican court to cancel any act that intentionally generated the insolvency of a debtor.

Moreover, fraudulent transfers can also be criminally charged, although the specific rules that regulate fraudulent transfers as crimes may vary from state to state.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

There are no widely accepted standard forms for loan documents. Acquisition financings typically require a short-form commitment letter to start the formalisation of acquisitions between seller and buyer. A term sheet with the terms and conditions of the acquisition may also be executed between seller and buyer. The term sheet usually sets forth the conditions and the term in which the full documentation will be required.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Levels of commitment may depend on the type and size of the transaction. For those small or midsize transactions, typically there is one or two lenders involved with a small level of commitment. With regards to larger transactions, lenders may increase in number and levels of commitment.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Typical conditions precedent to funding that are contained in commitment letters include the following:

- the execution of the agreements related to the financing;
- the accuracy and truthfulness in all material respects of the representations and warranties;
- the absence of defaults; and
- the delivery of any closing certificates, if applicable.

Additionally, it is customary to include the compliance of any conditions precedent related to the specific financing agreements, such as the perfection of security interests.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

It is not customary to include flex provisions in domestic financed acquisitions since they can be declared null. Flex provisions are commonly used in cross-border transactions.

The extent of these provisions may depend on the specific transaction, and its negotiation between the parties involved.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Security demands are not customarily used in acquisition financings executed in Mexico.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

One of the key elements of acquisition agreements in financed transactions that is relevant to lenders is the representations regarding:

- the fulfilment of the conditions regarding buyer's obligation to close;
- the fulfilment of the seller's covenants;
- the solvency of the buyer and target company either before or after the execution of the acquisition agreement; and
- the absence of events that would constitute a default in terms of the commitment letters.

Another key provision is the covenant that imposes an obligation on the seller to cooperate with the buyer in obtaining the buyer's financing contemplated by the commitment letters.

As protection to lenders, there are some provisions that are included with regards to the obligation of the seller not to sue the lenders in the event that the deal does not close; or the appointment of lenders as third-party beneficiaries of any limitation on liability of the buyers.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

With regard to private companies, there is no legal obligation to publicly disclose commitment letters or acquisition agreements. Therefore, it is not common to disclose acquisition agreements and/or commitment letters that involve private companies.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

To enforce against collateral, a final judgment issued by a court must be obtained. Regarding arbitration proceedings, in addition to the award issued by the arbitration ordering the foreclosure of collateral, a Mexican court must recognise such award to enforce such foreclosure.

Nevertheless, it is important to consider that with respect to security trusts and non-possessory pledges, Mexican law allows for the parties to agree out-of-court procedures for the foreclosure of collateral, which can simplify such a process.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Mexican bankruptcy law allows DIP financing. Once a company files for bankruptcy, it can request the court's authorisation for DIP financing to maintain the company's day-to-day operations, as well as the liquidity of the company during the bankruptcy process. If requested by the company, the court can authorise granting collateral to secure such financing.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

Under the Mexican Commercial Insolvency Law, as soon as the court declares the debtor in insolvency proceedings, no creditor may seize or execute any debtor's assets.

Also, during the insolvency proceeding, the court may issue injunctions to protect the debtor's assets and its creditors' rights. These injunctions may include the following, among others:

- the prohibition on making payments due before the date of admission of the request for bankruptcy;
- the suspension of all execution proceedings against the assets and rights of the debtor;
- the prohibition on the debtor to carry out operations of alienation or encumbrance of the main assets of its company;
- the securing of assets;
- intervention of the cashier's office;
- the prohibition on making transfers of resources or securities in favour of third parties;
- the order to arrest the debtor, for the sole effect that he or she may not leave the place of his domicile without leaving, through a mandate, a sufficiently instructed and authorised proxy when the person who has been taken into custody proves to have complied with the foregoing, the judge shall lift the restraining order; and
- any others analogous in nature.

There is no concept for 'adequate protection for existing lien holders who become subject to superior claims' under the Commercial Insolvency Law. However, these lien holders may be considered as creditors with secured credit or with a special privileged credit, which will help them to recover their credits before other creditors with common or subordinate credits.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

During an insolvency proceeding, a court may claw back previous payments to lenders if these payments were made by the debtor in fraud of creditors. The Commercial Insolvency Law provides for the acts considered as acts in fraud of creditors; for example, payments of unmatured obligations made by the debtor during the clawback period.

The clawback period in Mexican insolvency proceedings consists of the time when it is considered that the debtor was already in generalised breach of its obligations (insolvent). The clawback period covers 270 days before the court declares the debtor in insolvency proceedings.

For subordinate creditors, the clawback period is 570 days, regarding the acts in which such subordinate creditors were involved.

However, the conciliator, the receiver, an intervenor or any creditor may request the court to set a different clawback period. The clawback period cannot exceed three years.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

The Commercial Insolvency Law provides an order of priority for creditors to collect, subordinate creditors being the last to collect in the case of liquidation:

- employee credits for the last two years;
- social security credits;
- credits for the benefit and conservation of the debtor's patrimony (specialist in the insolvency proceedings);
- secured credits (mortgage and lien holders);
- special privileged credits (credits that are granted a special privilege by another Mexican law (eg, the credit of a carrier);
- debtor-in-possession financing;
- other employee credits and tax credits;
- common credits (unsecured credits); and
- subordinate credits (the credits of the debtor's related parties).

To reach a settlement agreement, the debtor must have the vote of creditors that represent 50 per cent of:

- the total amount of common and subordinated creditors; and
- the total amount of secured creditors and special privileged creditors.

If the subordinate credits represent 25 per cent or more of the total recognised credits, the subordinate credits will be excluded from the amounts mentioned above.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

The Commercial Insolvency Law provides for the right of the creditors to agree on the total or partial extinction of their credits, their subordination or a treatment that is less favourable than the treatment given to the creditors of the same rank. The requirement is that creditors' consent is expressly recorded in the reorganisation plan.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

Within the Commercial Insolvency Law, the claim of an OID or discount debt instrument does not have any special treatment. For these creditors to have a privilege, they must have been secured by a lien or mortgage.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

As a general rule, secured creditors would not be liable under Mexican law for enforced collateral, unless such creditor receives title to and becomes the owner or possessor of collateral that generates a specific damage (eg, environmental damages). In practice, it is not common that secured creditors are held liable for enforced collateral, since it is unlikely for such creditors to take title to or possession of collateral that could generate some type of liability.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

As part of a tax reform that became effective as of 1 January 2022, some amendments were made to the tax laws, which must be considered when executing a financed acquisition.

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These amendments include modifications in corporate restructurings, mergers and spin-offs (which are typically carried out during an acquisition); as well as in financing transactions.

Regarding corporate restructurings, mergers and acquisitions, with the new tax regime, in order to be entitled to request authorisation for a restructuring (and to transfer the shares at tax cost), as well as not to be considered as an alienation in the case of mergers and spin-offs, it is necessary to have a 'business purpose' when such transactions are carried out.

With respect to credit operations, if a credit operation has no business reason, it will be considered as a back-to-back loan with all its consequences (non-deductibility, recharacterisation as dividends, etc).

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Governing law

Most small to medium-sized acquisitions in the Netherlands are made by Dutch professional, institutional and strategic investors. Dutch law would typically govern the transaction agreements. Larger, cross-border transactions, are usually undertaken by inbound foreign professional and institutional financing and banking investors. These transactions tend, therefore, to be governed by the law that is most familiar to the financing parties, which is generally their domestic law (eg, their law of incorporation, English, New York, German or French law). It remains to be seen whether the uncertainties resulting from Brexit will result in an increase in Dutch law (or the law of other continental European countries) governing transaction agreements.

Choice of law

Dutch courts recognise the choice of foreign law to govern transaction agreements on the basis of Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). Rome I enables parties to agree that a contract may be governed by the law chosen by the parties to that contract, irrespective of the fact whether or not the chosen law is the law of an EU member state.

The freedom to elect the governing law does not apply to collateral agreements creating security over, inter alia, the shares in Dutch companies or partnership interests in Dutch partnerships or real estate situated in the Netherlands as these must be governed by Dutch law. Collateral arrangements over Dutch law receivables are mostly governed by Dutch law, although – in a cross-border context – possibilities exist for other laws to govern these collateral arrangements.

Recognition and enforcement of judgments

Dutch courts recognise and enforce judgments in civil and commercial matters obtained in other EU member states on the basis of, and within the limits set out in, Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) (Brussels I Regulation (recast)) and, in specific cases, the European Enforcement Order Regulation for uncontested claims ((EC) No. 805/2004).

Judgments in civil and commercial matters from the courts of Iceland, Norway and Switzerland are recognised on the basis of the 2007 version of the Lugano Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters (the 2007 Lugano Convention).

2005 Hague Convention

Further, as an EU member state, the Netherlands is also party to the Hague Convention on Choice of Court Agreements of 30 June 2005 (2005 Hague Convention). The 2005 Hague Convention shall apply in international cases to exclusive choice of court agreements concluded in civil or commercial matters. It sets out a mechanism that helps to determine whether parties have validly designated a court to have exclusive jurisdiction in cases where a dispute has arisen between the parties to the transaction agreements.

In addition, the 2005 Hague Convention determines how to establish whether the judgments from the designated courts will be recognised and enforced in the contracting states of the 2005 Hague Convention (currently the EU member states, Mexico, Singapore, Montenegro and the United Kingdom) (contracting states). Note that it is not necessary for the parties to the transaction agreement to have their seat in a contracting state.

As a consequence of the 2005 Hague Convention being limited to judgments given by a court or courts of a contracting state with exclusive jurisdiction, transaction agreements in which the parties have designated a court in a contracting state to have non-exclusive or asymmetrical jurisdiction shall be excluded from the Convention's scope. In cases of an asymmetrical jurisdiction clause, one party will exclusively designate a certain court to have jurisdiction while the other party shall not be prevented from taking proceedings in another court with jurisdiction.

Finally, the 2005 Hague Convention provides for a number of exceptions, such as the exclusions from scope (article 2) and the possibility for contracting states to declare that a matter is of strong interest to a contracting state resulting into the non-applicability of the Convention to that specific matter (article 21). The EU member states have filed such a declaration pursuant to article 21 in relation to certain types of insurance contracts. The 2005 Hague Convention also provides for grounds for a court to refuse the recognition and enforcement of a judgment (article 9).

Four possible scenarios can be established when determining whether choice of court agreements and judgments rendered in contracting states will be recognised and enforced in the Netherlands.

- parties to a financing agreement have designated a court in a contracting state to have exclusive jurisdiction in matters that fall within the scope of the 2005 Hague Convention (scenario 1);
- parties to a financing agreement have designated a court in a contracting state to have exclusive jurisdiction in matters that fall outside the scope of the 2005 Hague Convention (scenario 2);
- parties to a financing agreement have designated a court in a contracting state to have non-exclusive jurisdiction (scenario 3); and

- parties to a financing agreement have designated a court in a contracting state to have asymmetrical jurisdiction (scenario 4).

Recognition and enforcement of court judgments in scenario 1

A judgment given by a court of a contracting state designated in an exclusive choice of court agreement shall be recognised and enforced in any other contracting state (which includes the Netherlands) in accordance with the 2005 Hague Convention. Recognition or enforcement may be refused only on the grounds specified in articles 9 and 10 of the 2005 Hague Convention.

Enforceability of the foreign judgment in the Netherlands remains subject to the limitations and must be performed in accordance with the relevant provisions of the 2005 Hague Convention in conjunction with sections 985 through 994 of the Dutch Code of Civil Procedure, which causes the judgment to be enforceable in the Netherlands only once judicial leave to enforce the foreign court judgment in the Netherlands has been obtained from the appropriate Dutch court.

Recognition and enforcement of court judgments in scenarios 2, 3 and 4

When determining whether a judgment from a court in a contracting state will be recognised and is enforceable in the Netherlands in circumstances described in scenarios 2 through 4 above, it is, in the absence of authoritative Dutch case law on the subject matter, still uncertain what will be the legal basis for a Dutch court to base its judgment on. As each of the scenarios deal with circumstances whereby a court in a contracting state has non-exclusive jurisdiction. In these cases, the 2005 Hague Convention does not apply.

As regards scenario 2, it is important to note that matters will only be excluded from the scope of the 2005 Hague Convention if one of the excluded matters is an 'object' (the subject or one of the subjects) of the proceedings. This means that proceedings are not excluded from the scope of the Convention if one of these matters arises as a preliminary question in proceedings that have some other matter as their object or subject.

There are various reasons why the matters referred to in article 2(2) 2005 of the Hague Convention are excluded. In some cases, the public interest, or that of third parties, is involved, so that the parties may not have the right to dispose of the matter between themselves. In such cases, a particular court will often have exclusive jurisdiction that cannot be ousted by means of a choice of court agreement. In other cases, other multilateral legal regimes such as the Brussels I Regulation (recast) apply; so the 2005 Hague Convention is not needed, and it would sometimes also be difficult to decide which instrument prevails if the Convention were to cover such an area.

When determining whether a judgment from an English court will be recognised and is enforceable in the Netherlands, some legal scholars have suggested that Dutch courts might apply the Convention between the Kingdom of the Netherlands and the United Kingdom of Great Britain and Northern Ireland providing for the Reciprocal Recognition and Enforcement of Judgments in Civil Matters (the 1967 Convention). Alternatively, it has been suggested to apply the 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters (the 1968 Brussels Convention), whereas

others have pointed out that these Conventions have ceased to have effect as of the date the Brussels I Regulation (recast) (and its predecessors) entered into force.

Based on our reading of articles 68, 69, 70 and 76 of the Brussels I Regulation (recast), article 59 of the Vienna Convention on the Law of Treaties (the Vienna Treaty) and the first update of the information referring to article 76 of the Brussels I Regulation (recast), we conclude that the relevant provisions of the 1967 Convention and the 1968 Brussels Convention have been superseded by the provisions of the Brussels I Regulation (recast). We, therefore, take the view that the relevant clauses of the 1967 Convention and the 1968 Brussels Convention that have been superseded by the Brussels I Regulation (recast) (including any previous treaties or regulations dealing with these matters) and therefore have ceased to be effective in the Netherlands.

Currently, no information is available that leads us to believe that either the 1967 Convention or the 1968 Brussels Convention would revive following Brexit. Neither EU member states nor the United Kingdom have, as far as we are aware, indicated a desire for either of the aforesaid Conventions to revive.

Even more so, as there is no mechanism in either the 1967 Convention or the 1968 Brussels Convention to terminate either Convention, the UK Mission to the European Union has issued two written statements to the Secretary General of the Council of the European Union at the end of the Brexit transition period. On the basis of these statements, it may be concluded that the government of the United Kingdom considers that the 1968 Brussels Convention and the Rome Convention on the law applicable to contractual obligations of 19 June 1980 (80/934/EEC) have ceased to apply to the United Kingdom and Gibraltar from 1 January 2021, as a consequence of the United Kingdom ceasing to be an EU member state at the end of the Brexit transition period. It is believed that the United Kingdom issued the statement in accordance with article 56 of the Vienna Convention on the Law of Treaties, which article sets out how to terminate treaties that do not contain a provision regarding its termination, denunciation or withdrawal.

As regards the 2007 Lugano Convention for which the United Kingdom has applied for accession as an independent contracting state, the European Commission has decided not to accept the UK's request to accede to the 2007 Lugano Convention. As consent of all existing parties is required, including the EU, for the UK to accede as a contracting state, this possible route is now at an end. Therefore, alternative solutions will need to be assessed, one possibility being the Convention of 2 July 2019 on the Recognition and Enforcement of Foreign Judgments in Civil or Commercial Matters.

With none of the aforesaid Conventions seemingly applicable to the recognition of English court judgments in civil and commercial matters rendered in the circumstances mentioned in scenarios 2-4 above, no legal framework currently exists in relation to the recognition and enforcement of English court judgments in civil and commercial matters in The Netherlands. In relation to such cases article 431(1) of the Dutch Code of Civil Procedure determines that foreign judgments in civil and commercial matters cannot be enforced in the Netherlands in the absence of any applicable regulation or treaty.

In its decision of 26 September 2014 (ECLI:NL:HR:2014:2838) (*Gazprombank*), the Dutch Supreme Court has confirmed that in cases where no enforcement regulation or treaty

exists, a final and conclusive judgment rendered by a foreign court cannot be enforced in the Netherlands without the dispute having been relitigated before a competent Dutch court. See article 431(2) of the Dutch Code of Civil Procedure. When doing so, Dutch courts will have the discretion though to attach such weight to the foreign judgment as it deems appropriate, although Dutch courts are expected to adjudicate substantial importance to a final, conclusive and enforceable judgment, without full re-examination or full relitigation of the substantive matters adjudicated upon, provided that:

- the relevant court had jurisdiction in the relevant subject matter based on internationally accepted standards;
- the proceedings before the court complied with proper procedure and fair trial;
- such a judgment does not conflict with Dutch public policy; and
- such a judgment is not incompatible with (1) a judgment rendered by the Dutch courts in relation to a dispute that involves the same parties as the judgment that parties are seeking to enforce against a Dutch company in the Netherlands, or (2) a judgment rendered by a foreign court in relation to a dispute that involves the same parties as the judgment that parties are seeking to enforce against a Dutch company in the Netherlands, dealing with the same subject matter and is based on the same cause, provided that such previous judgment is recognised in the Netherlands.

A similar analysis will be performed by a Dutch court when dealing with judgments rendered by courts of the State of New York, as well as courts from other states with which The Netherlands has not concluded an enforcement and recognition treaty.

Possible alternative for the Gazprombank doctrine

If a Dutch court were to determine that the 1967 Convention still applies, the *Gazprombank* doctrine would, as a consequence, not apply. On the basis of the provisions of the 1967 Convention, it can be determined that a judgment given by a court with non-exclusive or asymmetrical jurisdiction in the United Kingdom, is enforceable in the Netherlands. However, such an enforcement in the Netherlands will be subject to the relevant provisions of the 1967 Convention in conjunction with sections 985 through 994 of the Dutch Code of Civil Procedure. Sections 985 through 994 of the Dutch Code of Civil Procedure cause the judgment to be enforceable in the Netherlands only once judicial leave to enforce the foreign court judgment in the Netherlands has been obtained from the appropriate Dutch court.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Restrictions on acquisitions by foreign entities are limited to two sectors: energy and telecommunication.

Under the Electricity Act 1998, notification to the Minister of Economic Affairs and Climate Policy (the Minister) is required in the case of any change of control in (an undertaking that operates) a production installation with a nominal electric capacity of more than 250MW. The concept of 'control' is derived from Dutch competition law principles and entails the possibility of exercising decisive influence. Public safety risks, as well as possible risks for

supply reliability and security, will be tested. If need be, measures will be taken. No stand-still obligation applies.

A similar filing obligation is included in the Gas Act in relation to a liquid natural gas (LNG) installation or LNG-company. Additionally, in the field of natural gas production, extraction and storage, a similar test forms part of the permit granting process under the Mining Act.

As for telecommunication, any intention to acquire 'predominant control' over a party active in telecommunication needs to be filed if this control leads to 'relevant influence' (as defined in the Dutch Telecommunication Act) in the telecommunication sector. The concept of 'predominant control' differs from the definition under Dutch competition and is, inter alia, already reached if the acquirer, solely or jointly with other persons that the acquirer cooperates with, has the power to exercise at least 30 per cent of the voting rights in the general shareholders' meeting.

A more general foreign investment screening mechanism that was announced to be retroactively applicable as from June 2020, and that relates, inter alia, to vital processes, is pending before the advisory body of the Dutch parliament.

Additionally, a foreign investment screening mechanism in relation to the Dutch defence industry is also in the making.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

The typical debt components of acquisition financing usually depend on the size and structure of the deal. Facility agreements are still the most common instrument in terms of debt financing in the Netherlands. Second lien and mezzanine financings are less popular. This is mainly due to the relatively high costs involved with second lien and mezzanine financings. In addition to the third-party debt, there is often a form of subordinated shareholder debt. Some acquisitions also involve a form of vendor loan financing, which is also subordinated to the third-party debt.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

In the event of a public offer a 'certain funds' rule applies. This rule provides that the bidder must procure that, by the time the request for approval of the offer document is filed with the Dutch Authority for Financial Markets, it is able to pay the consideration in cash or has taken all reasonable measures to provide any other kind of consideration to declare the offer unconditional. As a matter of market practice, the certain funds announcement is usually included in the first public announcement. The certain fund rule is not generally

applied in other transactions where not required, although it is not unusual for bidders to indicate in the term sheet how they intend to finance the transaction.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

A facility agreement generally provides for strict rules regarding the purpose and use of the term loans. Usually, the relevant proceeds have to be applied to finance the purchase price, fees and other costs related to the acquisition and financing thereof and the refinancing of the target's existing indebtedness.

A violation of these provisions usually constitutes an event of default. Further, under the finance documents usually a funds flow statement should be delivered as a condition precedent, setting out the application of the funds (including the relevant beneficiaries and related bank account details).

Also, if a Dutch notary is involved (eg, if the target is a Dutch entity), it is in line with common market practice in the Netherlands that the purchase price is paid into the third-party account of the notary. The notary will prepare a notary letter setting out the various steps to be taken on the closing date, including the payment out of funds to the beneficiaries (eg, the sellers and any outgoing lenders).

Loans utilised under a revolving facility may often be used for general corporate purposes (depending on the specific commercial arrangements on this, which shall be clearly stated in the purpose clause of the facility agreement).

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Lending, including inter alia, financing of commercial transactions (including forfeiting), is an activity listed in Annex I to the Capital Requirements Directive IV (2013/36/EU) (CRD IV). EU member states as the Netherlands have discretion as to whether various types of lending may be carried out by entities that are not regulated as banks (credit institutions) or otherwise. Where the provision of financing does not involve any involvement in regulated mortgages or consumer credit business, no licence is generally required in the Netherlands.

Corporate lending (ie, lending to non-consumers) as such is not regulated, but deposit taking is. Generally, Dutch financial regulatory law provides for a prohibition in respect of anyone acting in the pursuit of a business to attract, obtain or have at their disposal callable funds from the public. However, if the callable funds are attracted from professional market parties (PMPs) as defined in Dutch financial regulatory law, no licence is required. Persons from whom deposits are attracted are deemed to be a PMP if the amount of such deposits is at least €100,000 per drawing.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

In general, the Netherlands does not impose a withholding tax on arm's-length interest payments, repayments of principal and payments of related fees. An exception applies to interest payments to a lender that, solely or acting collectively with other lenders, may exercise such control that it can effectively influence the borrower's activities, if such lender (1) resides in a jurisdiction that is included in the annually updated Dutch list of low-taxed and backlisted jurisdictions or (2), in specific cases, is a hybrid vehicle. In such a case, a 25.8 per cent interest withholding tax applies. In debt capital markets transactions, there is generally not a gross-up obligation for Dutch borrowers with respect to the latter type of tax.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

There are no specific rules limiting the rate of interest in the context of commercial lending. However, if Dutch law is applicable, the finance documents (including the interest rate) may be affected and limited by the following:

- the principle of reasonableness and fairness, which governs the relationship between the parties to an agreement. This principle may impose additional obligations on the parties in the case of issues that are not covered by an agreement and this principle may also affect, inter alia, the reliance or enforcement of contractual provisions if such reliance or enforcement would be unacceptable;
- when interpreting a written agreement, the Dutch courts may take into consideration the intent of the parties at the time they entered into the agreement;
- an agreement may be annulled or may be void when it has been executed as a result of threat, fraud, undue influence or when it has been executed under the influence of an error regarding facts or mistake or when it is contrary to the principles of good morals or public order; and
- although legally speaking this does not limit the extent of debt financing, in practice the tax rules governing the deductibility of interest also have a limiting effect on the extent of debt financing. In addition to specific deduction limitations, in 2022 general earning stripping rules apply that limit the tax deductibility of interest expenses to the greater of €1 million or 20 per cent of the taxable EBITDA of the borrower.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

There are numerous indemnity provisions contained in a facility agreement covering various matters, including, but not limited to, indemnities for:

- taxes;
- stamp duty;
- the borrower's default (in particular, its failure to repay the loan);
- break costs;
- amendment or waiver costs in relation to the finance documents;
- costs resulting from conversion of currencies;
- costs and expenses arising from executing and documenting the transaction;
- costs relating to enforcement and preservation of security; and
- certain (increased) regulatory costs.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

Dutch law does not provide for any general restrictions on assignment of interests in debt among lenders. In the absence of a contractual agreement to the contrary, claims arising from facility agreements may generally be assigned freely by a lender to another lender (or a new lender).

General banking secrecy or data protection provisions may have to be complied with. A breach of these provisions would not render an assignment invalid but might lead to claims for damages.

However, pursuant to most facility agreements, transfers and assignments by a lender require the borrower's (or obligors') consent unless the transfer or assignment is (1) to another existing lender or affiliate or a related fund, (2) to entities on a permitted transferee list (or not listed on a blacklist) or (3) made while an event of default has occurred that is ongoing.

The consent of the borrower (or obligors) usually cannot be unreasonably withheld or delayed and some facility agreements provide that the borrower shall be deemed to have provided its consent if it does not respond within an agreed period of time.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Dutch law does not recognise the concept of 'trust' and there are no specific rules in the Netherlands governing the role of a collateral agent. Instead, it is in line with common market practice in the Netherlands that the finance parties to a facility agreement appoint one of the involved finance parties to act as security agent to represent the finance parties and to hold security on behalf of the secured parties on the basis of a parallel debt undertaking included in the facility agreement or intercreditor agreement.

Under Dutch law, it is not necessary for an agent or a security agent to be licensed, qualified or otherwise entitled to conduct business in the Netherlands to enable it to enforce its rights against the borrowers or other obligors under the finance documentation or by reason of the execution of the finance documents or the performance of its obligations thereunder.

Read this article on Lexology

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Generally, the standard LMA provisions on debt buy-back apply without any particular Dutch law-based deviations, pursuant to which buy-backs are either restricted or made subject to certain restrictions that a borrower or its equity sponsor will not disrupt voting arrangements among the lending group by purchasing debt. That said, a buy-back of loans is not as common in the Dutch market as buy-backs of notes or equity securities.

Exit consents

13 | Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Dutch law does not specifically restrict a borrower from soliciting lenders' consent in the context of amendment requests. The relevant debt agreements will determine whether majority lenders' consent is sufficient or whether all lenders' consent is required for a particular amendment request. With no contractual provisions to the contrary, Dutch law permits that majority requirements are solicited in a buy-back scenario, subject to compliance with general principles of law (eg, acting in good faith).

Under specific circumstances, such amendments can be challenged as an oppression of the minority, but the risk is reduced where the parties act in good faith with transparency and the same deal is offered to all parties in the same position and that is not a negative inducement.

GUARANTEES AND COLLATERAL

Related company guarantees

14 | Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

Whether or not restrictions apply to the provision of related company guarantees depends on the type of company providing the guarantee. Private companies with limited liability (BVs) are, in principle, not restricted in providing guarantees to related companies, as long as the granting of a guarantee is in the corporate interest of the grantor. Public companies limited by shares (NVs) are subject to Dutch regulations on financial assistance. Therefore, an NV and its subsidiaries may not grant security or guarantee the obligations of a related company if such security or guarantee is granted for the purpose of subscribing for or acquiring shares in its capital or depositary receipts for those shares. There are no limitations on the ability of non-Dutch, related companies to provide guarantees.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

Regulations on financial assistance only apply to NVs. Such companies and their subsidiaries may not provide security, give a price guarantee or otherwise warrant performance of or bind itself jointly and severally, or otherwise, in addition to or on behalf of others for the purpose of subscribing for or acquiring shares in its capital or depositary receipts for those shares.

NVs and their subsidiaries are furthermore limited in the granting of loans to related companies for the purposes described above. Such loans may only be granted if a board resolution has been adopted in that respect and provided that such board resolution has been preapproved by the general meeting of shareholders. Furthermore, a loan cannot be granted unless the following criteria are met:

- the loan is entered into and executed at arm's-length terms and conditions;
- the company's net assets less the amount of the loan are not less than the sum of the paid and called up part of its capital and the reserves that must be maintained by law or under its articles of association;
- the creditworthiness of the related company or companies are closely examined; and
- if the loan is granted for the purpose of acquiring shares due to an increase of the issued capital or for the purpose of acquiring shares that the company holds in its own capital, the price for acquiring any shares is fair.

If a transaction qualifying as financial assistance has been entered into on the basis of fraudulence conveyance, such a transaction can be nullified.

BVs are no longer subject to specific regulations on financial assistance. However, the board of managing directors of a BV needs to comply with the general rules for proper management before entering into a transaction that qualifies as financial assistance. This means that the transaction must be in the corporate interest of the company. Additionally, for the board of managing directors not to become liable due to the entering into of a transaction that qualifies as financial assistance, the (financial) consequences of the transaction should be properly assessed. The company must be able to continue to meet its obligations when due. The board of managing directors also needs to be transparent in relation to any conflict that might exist between the directors' interest and those of the company. Furthermore, the works council (if installed) and the board of supervisory directors (if installed) should be informed prior to the entering into of such transaction.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

The concept of floating and fixed charges is not known as such under Dutch law. Securities under Dutch law are divided into two categories: collateral security and personal security (such as joint and several debtorship, suretyship and guarantees).

Collateral security constitutes either a right of mortgage or a right of pledge. A right of mortgage can be created over registered property such as real estate, a parcel of land or registered aircrafts or ships. Any collateral other than registered property must be secured by way of a right of pledge. We note that some receivables might not be capable of being pledged under Dutch law if the underlying agreement contains a prohibition on the transferability or pledgeability of receivables.

Rights of pledge can also be created in advance over future movable assets and future receivables. Upon the pledgor acquiring the (future) movable assets or upon the (future) receivable arising, these assets are then directly encumbered with a right of pledge. However, insofar as future receivables are pledged in advance by way of an undisclosed pledge, only the receivables that arise out of a legal relationship that exists at the moment the pledge is created are covered by the pledge. Therefore, if a new relationship arises, a new right of pledge should be created to cover the receivables airing out of this new relationship. To avoid deeds of pledge having to be executed on a daily basis, Dutch banks have invented a specific security arrangement pursuant to which they can create undisclosed rights of pledge on all (future) receivables of their debtors without the debtors' involvement: the collective deed of pledge. Unspecified collective deeds of pledge can be registered with the Dutch tax authorities by the bank on a frequent basis, provided that the initial deed of pledge (master deed of pledge) has been executed by the pledgors and the bank and has been registered with the Dutch tax authorities. Such a master deed of pledge contains a power of attorney by the pledgor to the bank, on the basis of which the bank is authorised to register the collective deeds of pledge. By registering the collective deeds of pledge on a daily basis, all receivables of the pledgor are validly pledged.

The collective deed of pledge has some resemblance to an English floating charge, as both instruments create generic security. However, there are also several differences between the collective deed of pledge and the English floating charge. For example, floating charges cover all current assets of company in one single deed, while collective deeds of pledge need to be registered frequently to create rights of pledge and collective deeds of pledge can only cover personal claims.

It is not possible under Dutch law to create a blanket lien as security over registered property or shares needs to be created by way of a separate notarial deed. Taken the limitations in relation to future receivables into account, other collateral such as movable assets, receivables and interests in partnerships can be pledged by way of an omnibus pledge agreement.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

This depends on the specific type of security.

A mortgage must be executed as a notarial deed and must thereafter be registered with the relevant register of the Dutch public land registry. The method of perfecting rights of pledge depends on the collateral that is purported to be pledged and whether or not such collateral is pledged by way of a disclosed or an undisclosed right of pledge:

- a pledge over shares must be executed by means of a notarial deed;
- a pledge over movable assets can be perfected by (1) bringing the movable assets under the pledgee's control or (2) by execution of an authentic (notarial) deed or by execution of a private deed that is thereafter registered with the Dutch tax authorities;
- a pledge over receivables can be created by way of a disclosed or an undisclosed pledge:

    - disclosed: the right of pledge should be perfected by notification thereof from the pledgor to the relevant debtor; and
    - undisclosed: the right of pledge should be perfected by execution of an authentic (notarial deed) or by execution of a private deed that is thereafter registered with the Dutch tax authorities.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

There are no renewal requirements under Dutch law for security interests that have been validly created and perfected. However, if the corresponding secured obligations have been modified in any material way after the security has been created, a new (second ranking) security right might have to be created for the security rights to be enforceable.

It is common practice in the Netherlands for supplemental deeds of pledge to be executed and registered to create security over assets that are not yet capable of being pledged at the moment the initial deed of pledge is executed and (where relevant) registered.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

A Dutch company that has 50 employees or more on a regular basis is obligated to install a works council. If such company intends to grant any security or guarantee for an important debt of another company, the works council should be consulted. If the envisaged board resolution concerning the entering into of a security document or guarantee agreement constitutes an important decision by the company, the works council should be granted

the opportunity to render advice in relation to the board resolution. Following the advice of the works council, the board resolution shall be adopted. If the adopted board resolution is not in accordance with the advice of the works council, the company needs to suspend the implementation of the board resolution (ie, the granting of security) for a period of one month. During this period, the works council can decide whether or not to make an appeal with the Netherlands Enterprise Court at the Amsterdam Court of Appeal in relation to the adopted board resolution.

Depending on the articles of association of the relevant company, the board resolution concerning the granting of security or a guarantee might also be subject to (prior) approval by the general meeting (of shareholders) of the company.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Under Dutch law, security can be granted to an agent for the benefit of all lenders, provided that the underlying loan agreement or the separate security documents include correct provisions on parallel debt. Parallel debt provisions are required since Dutch law is not conclusive as to whether a person can hold security rights for the benefit of another person. The parallel debt provisions should at least reflect that (1) the borrower undertakes (the 'parallel debt') to pay the security agent in its own right and not as representative of the other finance parties, sums equal to each amount payable by it under the finance documents, (2) the security agent shall have its own independent right to demand and receive payment of the parallel debt and (3) the parallel debt is owed to the security agent in its own name on behalf of itself and not as agent or representative of any other person and that the security documents shall secure the parallel debt owing. The loan agreement should further include provisions pursuant to which the other lenders have a contractual claim against the security agent.

It would also be possible to create security in favour of multiple beneficiaries using the principle of a community within the meaning of section 3:166 et seq of the Dutch Civil Code. Each beneficiary would in such a case be entitled to the assets of the community and to a part of the security right corresponding to its individual share in the community. If this route is chosen, the beneficiaries should enter into an (intercreditor) agreement setting out the conditions for enforcement.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Dutch law does not deal with provisions on creditors' protection before the release of a security right.

Security rights cease to sort any effect after the corresponding secured obligations have been fully satisfied and discharged. Security rights are generally released upon the secured obligations having been fulfilled by means of a release agreement.

The Dutch Civil Code states that a security right can be terminated if the authority thereto has been granted to the security provider, the beneficiary or both on the basis of law or at the time of creation of the security right. It is, therefore, market practice in the Netherlands for security documents to contain a provision pursuant to which the beneficiary is entitled to terminate the security right.

If a right of mortgage is to be terminated, this right of mortgage should also be deregistered from the relevant register of the Dutch public land registry.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

Dutch law contains separate provisions on fraudulence conveyance that apply either during bankruptcy or outside of bankruptcy. Pursuant to the fraudulence conveyance provisions that apply outside of bankruptcy, a voluntary legal act that negatively affects the recovery position of creditors of a company can be nullified if the company performing the voluntary legal act knew that the performance thereof would negatively affect the recovery position of its debtors. Furthermore, if the legal act is performed for a consideration, the legal act can only be nullified if the counterparty also knew that the legal act would negatively affect the recovery position of the company's debtors.

The fraudulence conveyance provisions that apply during bankruptcy are generally the same; however, such provisions also relate to mandatory legal acts. It is up to the bankruptcy trustee of a company to prove that a legal act has been performed on the basis of fraudulence conveyance for the legal act to be nullified. In this respect, the bankruptcy trustee can rely on evidentiary presumptions that are included in the Dutch Bankruptcy Act.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

In most cases, debt commitments are governed by foreign laws. Legal techniques and the sequence of documentation prevailing in Anglo-Saxon legal practices are customarily used in the Netherlands. There is, therefore, no standard practice in the Netherlands, and the full set of documents would be familiar to Anglo-Saxon investors.

In the initial steps towards the transaction, acquisition finance documents will usually include a letter of intent, a commitment letter issued by the bank or financing parties, or

both, a term-sheet, a fee letter and, to the extent a capital markets transaction is involved in the acquisition financing, an engagement letter and often a fee credit letter.

The closing documentation will typically include a credit facility agreement, with the financing banks or loan agreements with financing parties, whether subordinated or not, and various finance documents that would comprise a 'security package' including:

- pledge over receivables;
- pledge over shares;
- pledges over bank accounts and other charges on movable and immovable assets with forms of all required notices to be sent under the security documents;
- any hedging arrangements;
- subordination agreements and intercreditor agreements;
- equity documents; and
- utilisation requests.

English concepts of debenture are not used in The Netherlands in as much as this type of general security is unlikely to be enforceable under Dutch law. Apart from the commitment letter and letter of intent, the documentation is contemporaneously signed on the day of the closing of the acquisition. Signing in counterparts is common practice in the Netherlands and exchange of executed documentation by fax and electronic copy (with originals to be provided later on) is validly recognised. Note that this is only relevant in the event of private deeds, as notarial deed cannot be executed in counterparts.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

The level of commitment is a commercial matter and will depend on the relative bargaining positions of the parties and the ticket size of the transaction. As a rule of thumb, the larger and the more complex an acquisition, the higher the level of commitment. For small to mid-sized ticket transactions, the commitment will usually hinge on a single lender, sometimes a two-bank club deal, with a lower level of commitment. In practice, this will often depend on the internal procedures of the credit committee of the lender or the lenders and the attractiveness of both the borrower and the acquisition in question.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The conditions precedent usually mirror those found in cross-border transactions in general. They will usually include the constitutional documents in the form of the deed of incorporation, the articles of association and an excerpt from the Dutch trade register and the more transaction-specific conditions precedent, such as the group structure chart, the funds flow diagram, corporate resolutions, legal opinions, etc. The Netherlands benefits

from a publicly available companies register that provides a highly transparent and updated source of corporate documentation.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Banks often ask for market flex clauses, allowing them to modify the agreed terms of the loan unilaterally if syndication turns out to be more difficult than expected. Such flex usually permits arrangers to increase the margin, original issue discounts or upfront fees, as well as to reduce the size of certain baskets or to delete growers or make other changes to the financing structure, pricing and financial maintenance covenants (if any).

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demands are sometimes seen in Dutch acquisition financings, depending on the then-current market conditions and size of the bridge loan. Alternatively, bridge facility agreements often provide for factual requirements (such as the short maturity) or incentives (such as significant margin step-ups after the lapse of a certain period of time) to refinance the bridge facility by means of securities or a term loan B.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

The key elements in the acquisition agreement that are relevant to the lenders in the Netherlands include:

- the provisions regarding the purchase price;
- certain representations and warranties regarding the acquired shares (or property), such as them being sold free and clear of any encumbrances;
- the provisions regarding the repayment of any existing debt and release of existing security;
- the provisions governing the transfer of any rights under the acquisition agreement, in order to ensure that the purchaser (either acting as borrower or obligor) may grant security to the lenders over its (present and future) rights against the sellers under the acquisition agreement;
- the scope of any indemnities; and
- the conditions precedent to closing and the closing mechanics.

Acquisition agreements typically do not deal with the rights or liabilities of lenders, and those will usually be part of the finance documentation between the lenders and borrower.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

Commitment letters and acquisition agreements are not publicly filed for private acquisitions. For public acquisitions the offer and the description of the financing is filed with the Dutch FSA at the time the offer is made to the public. However, the more detailed finance documentation is not made publicly available.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

A secured creditor may foreclose on the secured assets if there is a default in the performance of the secured obligations.

Secured creditors are not affected by the opening of insolvency proceedings and may act as if there were no insolvency proceedings, unless a 'cooling-off period' is ordered by the court.

A cooling-off period may be ordered by the court for up to two months, and can be extended once, by a maximum of two months. During the cooling-off period, a secured creditor cannot enforce against its collateral without court permission.

During bankruptcy, the bankruptcy trustee may set a time frame during which the secured assets need to be sold by the secured creditor. Failure to do so will result in loss of the right to foreclose on the secured assets (although the secured creditor's claim will continue to have a high preference, the secured creditor will have to share in the bankruptcy costs).

During a WHOA proceeding, a stay may be granted by the court, which will prevent the secured creditor from enforcing against the collateral.

Lastly, a security provider may request the court in summary proceedings to stop enforcement if it is of the opinion that enforcement is not justified.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Pursuant to the Act on the confirmation of private plans (WHOA), which entered into force on 1 January 2021, a debtor can file for reorganisation proceedings during which the debtor may retain control throughout the entire restructuring procedure, which is comparable to the concept of debtor-in-possession (DIP) proceedings.

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Once the WHOA process has been initiated, the restructuring efforts (including DIP financings) may be protected from annulment based on fraudulent preference if court consent is obtained with respect to the relevant legal act (which, generally speaking, will be given if that is necessary to continue the debtor's business during the restructuring process).

Without the protection offered by the WHOA, the advance of (new) emergency funding required for the restructuring would be at risk of becoming annulled if the restructuring attempt failed and the debtor went bankrupt. The WHOA also prevents the bankruptcy trustee from claiming that a set-off performed during the restructuring process took place in bad faith and be annulled.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

Bankruptcy

During bankruptcy, there is an automatic stay, and most pending legal proceedings are suspended. Secured creditors are not affected by the stay, unless a 'cooling-off period' is ordered by the court.

Suspension of payments

During suspension of payments proceedings, a limited stay applied unless a cooling-off period is ordered by the court.

Preferential and secured creditors are, provided no cooling-off period applies, not affected by suspension of payments proceedings. Unsecured ordinary creditors can initiate or continue legal proceedings, although they cannot foreclose a judgment to enforce payment.

WHOA

At request of the debtor or the court-appointed restricting expert, the court can allow a stay for a maximum of four months, with a possibility of extensions up to a maximum of eight months.

Generally, the stay will be granted by the court if it appears to be necessary for the continuation of the debtor's business during the restructuring process.

The stay prevents all parties from claiming or taking recourse against the debtor's assets without court consent, provided they have been informed of the stay or are aware of the ongoing WHOA process. Attachments may also be lifted and any request to open insolvency proceedings against the debtor will be suspended.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

During bankruptcy, the bankruptcy trustee has the right to challenge (voluntary) legal acts by the debtor where there was no prior legal obligation to perform them (not mandatory by law or contract). The bankruptcy trustee can annul such legal acts, with the effect that the act is deemed to have never occurred.

The bankruptcy trustee must prove that the following requirements are satisfied:

- the legal act adversely affected the possibility of recourse of the debtor's creditors (ie, prejudicial effect);
- the debtor knew (or should to have known) that the legal act would adversely affect the possibility of recourse of its creditors; and
- if the legal act was for consideration, the debtor's counterparty knew (should have known), that the legal act would prejudice the interests of the debtor's creditors.

If the legal act was for no consideration (for example, a payment well below the actual value), the bankruptcy trustee is only to prove that the debtor knew that the legal act would adversely affect the possibility of recourse of its creditors.

Under circumstances, there is a shift in the burden of proof to the advantage of the bankruptcy trustee. If certain voluntary legal acts – including the payment of, or granting of security for, debts which are not yet due – were performed in the year preceding the bankruptcy, knowledge that such legal act would prejudice the debtor's creditors (and that both the debtor and the counterparty were aware of this) is presumed by law.

In addition, the bankruptcy trustee is able to annul legal acts that were performed on the basis of a prior legal obligation, if the bankruptcy trustee can evidence that: (1) the counterparty knew that a petition for bankruptcy was filed at the time that the act was performed and the debtor was subsequently declared bankrupt, or (2) the performance of the act was a result of consultations between the debtor and counterparty with the aim of preferring that counterparty over the other creditors.

Consequently, a debtor under a legal obligation to pay a certain creditor may still be confronted with a challenge by the bankruptcy trustee.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Ranking in bankruptcy

Secured creditors are in general not affected by bankruptcy and a secured claim is paid out of the enforcement proceeds of the security right (ie, not out of the bankruptcy estate).

A bankruptcy trustee will first pay 'estate claims' and thereafter the pre-insolvency claims (being preferential claims (the majority of which tend to be held by the tax authorities and social security board) and unsecured claims).

Unsecured (ordinary) creditors must submit their claims to the bankruptcy trustee. Payments to unsecured creditors can only take place on a pro rata basis.

Estate claims are, generally, claims incurred by the bankruptcy trustee in performing his or her duties, which just like insolvency costs have priority over the unsecured (ordinary) and preferred claims against the debtor.

In principle, the bankruptcy trustee is principle authorised to make payments to estate creditors, certain preferential creditors or 'force creditors'. Force creditors are creditors that have a strong position because the estate required their services (for example, a supplier whose products or services are essential to continue the business).

Plan of reorganisation during bankruptcy and suspension of payments

A plan of reorganisation may be proposed by the debtor in a bankruptcy or in a suspension of payments.

There are no mandatory requirements or features for a plan for reorganisation. However, a successful reorganisation often requires the cooperation and commitment of major creditors before initiating insolvency proceedings.

A plan that is accepted by a majority of the unsecured creditors and approved by the court, will only be binding on all unsecured creditors. Unless they agree so, preferential and secured creditors are not bound by the plan.

Unsecured creditors that submitted their claims (which were accepted or conditionally admitted) and are present at the meeting must approve the plan by a simple majority representing at least 50 per cent of the total value of the unsecured claims. If the required majority do not vote in favour of the plan, the supervisory judge may, upon request, approve the plan if at least 75 per cent of those creditors who submitted their claims (which were accepted or conditionally admitted) approved the plan, provided that the plan was rejected by one or more creditors who could not have reasonably voted against the plan.

Plan of reorganisation during WHOA proceedings

Under the WHOA, a debtor (that is not an insurer or bank) can present a restructuring plan to (certain of) its creditors or shareholders if it can reasonably be assumed that the debtor will not be able to continue to pay its debts as they fall due in the near future. In addition, any creditor, shareholder or, if established, the debtors' works council (or other employee representative body) can request the appointment of a restructuring expert to prepare a restructuring plan on the debtor's behalf.

The debtor may determine which (secured) creditors or shareholders will be included in the restructuring plan. Excluded creditors and shareholders fully retain their rights and the rights of employees under employment contracts cannot be amended under the WHOA.

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Parties must be placed in different classes if their rights are so different they are not in a comparable position. This will be the case if, amongst others, in an enforcement against the debtor's assets the parties have a different ranking under Dutch law. Secured creditors' claims will be split, a separate class is required for the part of a claim which is covered by the security right (ie, for amount for which the claim is 'in the money') and another class for that part of the claim that is unsecured (ie, the residual claim after enforcement or liquidation of the underlying asset). For the residual part of the claim the secured creditor will be placed in class of unsecured creditors. In addition, small creditors (that provided goods or services) must be placed in a separate class if the restructuring plan envisages that less than 20 per cent of their claims will be paid.

All creditors or shareholders whose rights are affected by the restructuring plan are entitled to vote.

A class will have accepted the restructuring plan if a two-thirds majority in value of its outstanding claim or capital votes in favour of the plan. No head-count requirement applies.

The debtor or the restructuring expert may submit a request to confirm the restructuring plan to the court if at least one class of creditors has voted in favour of the plan. If the debtor is a small or medium-sized enterprise, the restructuring expert can only seek court confirmation with the consent of the debtor.

The court must, on its own initiative, refuse confirmation of the restructuring plan if certain general grounds for refusal apply.

At the request of one or more creditors or shareholders (who rejected the restructuring plan or who were wrongly excluded from the vote), the court may refuse to confirm the plan if a party receives less in value than it would receive in the liquidation of the debtor's assets in bankruptcy (ie, the 'best interest of creditors test'). In addition, at the request of one or more creditors or shareholders (who rejected the restructuring plan and were placed in a class that did not accept the plan or were wrongly excluded from the vote and should have been placed in a class that did not accept the plan), the court must refuse to confirm a plan if:

- the distribution of the realised value deviates to the disadvantage of the class that did not accept the plan from the ranking that applies upon enforcement against the debtor's assets under Dutch law or any other law, instrument or contractual arrangement binding on the debtor, unless there are reasonable grounds for such deviation and the interests of the relevant parties are not prejudiced by it (ie, a form of an 'absolute priority rule'); or
- the plan does not give the relevant party a right to opt for a cash payment in the amount that party would have expected to receive in cash in a liquidation of the debtor's assets in bankruptcy (the 'cash-out option'). The cash-out option is not available to secured creditors, unless they have been offered shares and were not given the option of another form of distribution.

The supplementary grounds for refusal are largely inspired by the US Chapter 11 'best interest of creditors test' and the 'absolute priority rule'.

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Following court approval of the restructuring plan, the plan becomes binding on all relevant parties, including any dissenting parties, in accordance with the provisions of the WHOA. As a result, the court will have the power to 'cram down' dissenting classes who voted against the restructuring plan, provided that lower-ranking classes cannot 'cram up' higher ranking classes.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

The priority of liens depends on the time the relevant lien is created.

However, secured creditors [and the debtor] may agree on the application of enforcement proceeds among themselves. Such agreements are usually contained in the intercreditor agreement, requiring the security agent or trustee to enforce the transaction security and distribute the enforcement proceeds to the various secured creditors in accordance with their ranking. Usually, senior and junior lenders share a single security package, and junior claims are subordinated on a contractual basis. Although subordination agreements are enforceable in the case of insolvency of the debtor, 'subordination' does not have a defined meaning under Dutch law. A subordination agreement will be interpreted in accordance with the intentions of the parties and its meaning is primarily determined referring to the terms of the agreement.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

Dutch insolvency law does not explicitly deal with the treatment of claims arising from an original issue discount. Creditors who acquire a debt of a company at a discount to the nominal value may enforce and, in the event of bankruptcy, submit their claim to the bankruptcy trustee for the nominal amount.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

As a principle under Dutch law, (bank) lenders will have a duty of care towards the borrower or security provider to, where reasonably possible and appropriate, take other proportionate measures before accelerating the loan and enforcing against the collateral. A secured creditor that enforces against collateral, generally, sells the collateral 'as is' to a buyer and together with any potential liabilities (including environmental liabilities) to which the collateral is subject.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

On 2 June 2020, the legislative proposal 'Amending the Civil Code in connection with the exclusion of contractual prohibitions on assigning or pledging monetary claims' was submitted to the Lower House of Parliament. The bill contains a new article, which stipulates that, with respect to 'trade receivables'(registered money receivables arising from a profession or business), a clause between parties that is intended to exclude their transfer or pledge, or to prevent their alienation or pledge, is void (invalid). The bill is intended to benefit creditors.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Agreements whose purpose is the financing of the acquisition of Spanish companies when the borrower is also a Spanish company are usually governed by Spanish law. In the past, larger transactions were executed under English law, and although in recent years the use of English law has been extended to include smaller deals, Spanish law continues to be the norm.

Security agreements over assets located in Spain or shares of Spanish companies must be subject to Spanish law.

According to Regulation (EC) No. 593/2008 (Rome I) on the law applicable to contractual obligations, Spanish courts will recognise any foreign law governing financing agreements, owing to Rome I having erga omnes effects. This means that any foreign law is enforceable, irrespective of whether or not it corresponds to an EU member state and provided that validity of that foreign law is proved within the relevant judicial proceeding; nevertheless, any Spanish public policy mandatory provisions will apply.

The submission to a foreign jurisdiction is valid in Spain provided that the exclusive jurisdiction rules established either in the recast Brussels Regulation ((EC) No. 1215/2012) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters or Spanish law (as applicable) are complied with.

Judgments given by a foreign court are enforceable in Spain in accordance with Regulation (EC) No. 1215/2012 (when referring to judgments issued by an EU member state court), or according to Spanish civil procedure regulation (when referring to final judgments issued by a non-EU member state), which establishes that any final judgment rendered outside of Spain may be enforced in Spain under the following conditions:

- it is in accordance with an applicable international treaty; and
- in the absence of any such treaty, provided that certain requirements are met (such as that the court that issued the judgment has jurisdiction, the judgment is final and does not contradict Spanish public policy nor previous Spanish resolutions).

In the case of judgments given by a non-EU member state (including, from 1 January 2021, the United Kingdom), Law No. 29/2015 on international judicial cooperation includes a

'general principle favourable for cooperation' in respect of the recognition and enforcement of foreign judgments.

In principle, foreign arbitral awards are also enforceable in Spain according to the 1958 New York Convention on recognition and enforcement of arbitral awards.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

The general rule is that acquisitions by foreign entities are not restricted. In some cases, acquisitions may be subject to administrative authorisation (for instance, where the target holds an administrative concession, or is subject to a special regulatory regime, as would be the case with banks and financial services companies), but these would apply to both Spanish and international acquirers.

Amid the covid-19 pandemic, Royal Decree 11/2020 of 31 March and Royal Decree 34/2020 of 17 November have restricted foreign investments (ie, non-resident EU or EFTA investors) in companies acting in sensitive sectors (eg, critical infrastructure, critical technologies and dual use items, supply of critical inputs, access to sensitive information or media). As a general rule, foreign direct investments exceeding €1 million are subject to prior authorisation of the board of ministers of the Spanish government when it comes to acquisitions exceeding 10 per cent of the target company stock or triggering a change of control.

In addition, Spanish companies engaging in transactions with non-residents in Spain must deliver information to the Bank of Spain on a regular basis concerning these transactions (eg, with foreign banks or foreign entities) and the corresponding balances of their foreign financial assets and liabilities.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Both senior debt and subordinated debt are typically included in acquisition financing in Spain. Junior debt may be provided by mezzanine lenders or by sponsors through 'participative' loans that are legally subordinated or by both.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

In acquisitions of public companies where a tender offer is required, a tender bond is mandatory, so that there is certainty of funding. Acquisitions of shares in public companies that do not trigger a mandatory tender offer are not subject to this requirement.

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While there is no legal requirement for private acquisitions, 'certain funds' provisions are the norm in acquisition finance agreements.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

The only restrictions applicable are those agreed by the parties under the finance documentation. The parties usually agree on the purpose of the financing as:

- payment of the purchase price and related costs and taxes;
- repayment of existing debt of the target company; or
- attending to working capital needs.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Lending money in Spain can be carried out in Spain without any prior requirement being met by the relevant lender; in particular, no prior authorisation from the Spanish banking authorities is required. This applies to both bilateral loans and syndicated facilities. However, additional banking activities, such as raising reimbursable deposits from the public, are subject to certain requirements being met with regard to the Spanish banking authorities.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

A withholding tax may have to be paid by the borrower on interest paid to any foreign lender unless the lender is either a resident in an EU member state and the beneficial owner of the interest received, or, in the case of non-EU residents, resident in a jurisdiction that has signed a double tax treaty agreement with Spain that regulates a full exemption on Spanish-source interest and fully entitled to the benefits of such a treaty (ie, a 'qualifying' lender). Otherwise, any other non-resident (entity or individual) would be subject to a 19 per cent withholding tax or to the specific rate established by an applicable double tax treaty.

Furthermore, subject to compliance with certain requirements, the following exemptions are applicable with regard to interest payments made to a non-resident that does not act in Spain through a permanent establishment to which the interest is deemed allocated:

- Spanish public debt;
- non-resident bank accounts;
- preference shares and bonds issued by Spanish financial institutions;
- securitisation funds;
- preference shares issued by non-financial listed entities; and

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- listed debt instruments issued by listed and unlisted Spanish companies and public entities.

Loan agreements typically include tax indemnity and gross-up provisions (Loan Market Association standard or similar) in favour of qualifying lenders. Also, debt transfers are usually restricted to other entities that are deemed qualifying lenders (otherwise, the indemnity and gross-up provisions generally do not apply in favour of the transferees).

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Under Spanish law, pursuant to the Spanish Usury Act of 23 July 1908, which remains in force, any financing agreement shall be null and void if the interest agreed under the agreement is substantially higher than the interest commonly agreed in similar transactions in the market and manifestly disproportionate to the circumstances applicable to the relevant transactions or leonine (provided that the borrower has most likely accepted such interest based on its lack of experience or its distressed situation).

Once the nullity and voidness of the relevant financing agreement has been declared, the borrower will not be obliged to pay any interest due under such an agreement.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

Loan agreements typically include indemnities for currency conversion, taxes, payments not made on the due date, failure to make any prepayment following a prepayment notice, changes in any law or regulation after the execution of the agreement, etc.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

In principle, yes, subject to agreement by the parties. Assignability provisions are heavily negotiated in Spain and would usually include a definition of qualifying lenders that excludes potential lenders whose entering into of the finance documentation would involve additional costs or taxes for the borrower (in some cases 'vulture' funds are excluded as well) and a requirement for the assignor and the assignee to carry out such assignment following the required legal procedure and delivering the relevant notice of assignment to the borrower.

It must also be taken into account that some security interests can only be granted (or assigned) in favour of certain categories of finance parties. For example, financial collateral may only be granted in favour of banks or other types of financial lenders, but not special-purpose vehicles or corporate lenders. Floating mortgages may only be granted in favour of banks and certain other types of financial institutions.

Requirements to act as agent or trustee

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Spanish law does not recognise trusts and, although not expressly regulated, administrative agents and collateral agents are recognised in Spain based on the existence of Spanish regulations on mandates and similar legal figures.

Debt buy-backs

12 May a borrower or financial sponsor conduct a debt buy-back?

Debt buy-back provisions are not standard under Spanish law unless financing is carried out as bonds or notes issuances or similar, in which case repurchase or amortisation of bonds and notes is usually agreed subject to certain conditions.

Disenfranchisement provisions are typically included in loan agreements where buy-backs are contemplated.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Debt buy-back provisions are not standard under Spanish law. Nonetheless, it would be possible for the parties to include exit consents and similar clauses in loan agreements.

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

Provided that there is no prohibited financial assistance, no restrictions apply to the granting of downstream guarantees. Based on recent case law, upstream and cross-stream guarantees require a corporate benefit to be received by the guarantor. When referring to downstream guarantees, such corporate benefit may rely on the guarantor benefiting from its subsidiaries' value increase or on the guarantor receiving dividends. However, when referring to upstream or cross-stream guarantees, as this benefit is not that clear, the parties would normally agree on a consideration to be paid to the guarantor.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

Under Spanish corporate law, Spanish companies shall not provide financial assistance to facilitate the acquisition of their own shares or the shares in their respective parent companies and, in case of private limited liability companies, also to facilitate the acquisition of shares in other group companies. Any financial assistance provided in breach of a prohibition is null and void. For these purposes, the term 'financial assistance' is understood to cover any kind of financial assistance, for example by means of issuance of a guarantee or granting of a loan, among others.

Within acquisition finance transactions, Spanish companies would normally guarantee or secure the payment obligations arising from any tranches of the acquisition facility or any additional facilities to the extent that they are granted to finance purposes other than the acquisition price and related costs and expenses, such as the refinancing of pre-existing indebtedness of the target or target group (to the extent that indebtedness does not qualify as acquisition debt), working capital requirements, future investments, etc.

In spite of the above, in general, with reference to leveraged mergers and other corporate transactions (eg, share capital reductions, segregations or dividends distributions), the Spanish legal community understands that Spanish corporate legislation applicable to such corporate processes sufficiently protects all interests that are ultimately protected by the financial assistance prohibition (mainly those of minority shareholders, creditors and employees), either by means of regulating information or objection rights for creditors, etc, as applicable, and that the risk of the corporate transactions being challenged is relatively low.

In particular, section 35 of Law No. 3/2009 of 3 April 2009 on structural modifications of companies regulates merger processes involving a company having received financing (within the preceding three years) to acquire the shares or assets of another company also involved in the merger process, and establishes certain requirements to be met, which may dilute the risk of breaching the rules on prohibited financial assistance.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

The most common types of security are in rem security interests such as:

- mortgages over real estate;
- possessory pledges over shares and credit rights or bank accounts;
- chattel mortgage;
- non-possessory pledges; and
- personal guarantees.

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Mortgages over real estate are rare in acquisition finance deals owing to their exorbitant cost, because they will attract an ad valorem stamp duty. Promissory mortgages are used in some cases as an alternative.

Spanish law neither recognises nor regulates floating and fixed charges (except for certain mortgages over real estate) or blanket liens. A security agreement is usually required in relation to each type of asset subject to security.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Each type of security is subject to a specific body of law:

- the Mortgage Act for real estate mortgages;
- the Chattel Mortgage and Non-Possessory Pledge Act for these types of security; and
- the Civil Code for other pledges (pledges over bank accounts, receivables or shares).

As a general rule, agreements of creation of security interests shall be executed before a public notary (except for agreements for the creation of financial pledges, where a private document, in principle, suffices). When referring to security over bank accounts, for it to qualify as financial collateral, the beneficiary must hold control over the moneys deposited in it, in the sense of their consent being mandatory for carrying out any action over such moneys.

Additionally, mortgages over real estate must be registered with the property registry and chattel mortgages, and non-possessory pledges must be registered with the movable assets registry.

When referring to a pledge over receivables, a notice to the relevant debtor is not mandatory for the perfection of the security, although such notice will be required before enforcement of the same.

Additionally, with reference to a pledge over a public limited liability company's shares represented by share certificates, such share certificates (duly endorsed in favour of the pledgee) must be delivered to the pledgee or to a third party acting as a custodian of the collateral (eg, the security agent). In such a case, or where a pledge is in the form of shares in a private company, it is standard market practice to annotate the creation of the pledge in the shareholders' registry of the issuing company, with the secretary of the board of directors certifying that the annotation has been made. The creation of the pledge must also be annotated in the ownership title.

Likewise, with reference to a pledge over a public limited liability company's shares represented by book entries, the pledge must be recorded in the special registry kept by the relevant entity in charge of bookkeeping entries for the relevant shares that are participating in the Spanish clearing and settlement system. This entity certifies the registration of the pledge.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

No. It is not required to keep the security in force. However, pledges over future receivables are usually updated on a periodic basis to include the proper identification of any receivables subject to the pledge by means of the execution of an additional notarial document.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

No 'works council' or similar consents are required under Spanish law.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Lenders tend to appoint an agent for the Spanish security, which would hold the Spanish security in its own name and on behalf of the other secured parties. However, when referring to security subject to registration with a public registry, all lenders would usually appear as beneficiaries of that security.

Under Spanish law, assignment of the secured obligations involves a proportional subrogation of the new lender into the existing security covering the same. Documentation of that assignment will normally include a reference to that subrogation, and when referring to a security subject to registration with the appropriate public registry (either the property registry or the movable assets registry) that documentation must be filed with the competent registry for the latter to reflect the assignment and to register the new lender as the new beneficiary under the security (provided that the assignee qualifies as a potential beneficiary of the relevant security).

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Such protection is not typical in Spanish structures.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

Spanish law punishes any transactions made with a fraudulent purpose or intent. In particular, asset stripping is punished by the Spanish Criminal Code and may entail severe

penalties (such as imprisonment), together with any penalty that may arise from an asset stripping leading to, or in the context of, an insolvency situation, which may also entail additional penalties as per the Spanish Insolvency Act. Likewise, it must be noted that, within an insolvency judicial proceeding, any transaction carried out within the two years preceding the declaration of insolvency that damages the insolvency's estate can be clawed back, regardless of whether it has been executed with fraudulent intent. If it is evidenced that as a result of a fraudulent transaction an asset stripping took place, severe liabilities may be imposed on the parties to the relevant transaction (mainly economic penalties and prohibition to manage companies in the future).

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

A short-form debt commitment letter together with a term sheet (not necessarily well detailed) is the documentation usually required prior to the relevant bid. Full documentation is required for closing.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

This depends on how strong the position of the sellers may be while negotiating with the potential purchasers. If they are in a very strong position, they usually require fully underwritten commitments or club deal structures with commitments by each of the members of the club deal.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Typical precedent conditions are those included in the term sheet, which are usually, among others:

- executed finance documentation;
- delivery of copies of constitutional documentation, corporate resolutions and financial and know-your-customer information of the obligors (their accuracy being certified by authorised signatories of the obligors);
- accuracy of representations and warranties;
- issuance of power and capacity and validity and enforceability of legal opinions;
- acquisition documentation satisfactory to the lenders; and

- no material adverse event or breach of provisions under the finance documentation.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Flex provisions are not very common in the current market under Spanish law. Margin and tenor were once the terms typically subject to such flex.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demands are not a key feature in acquisition financing in Spain. However, some transactions subject to New York laws have included these commitments by the borrower.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Lenders will typically look at conditions to closing being consistent with 'certain funds' conditions and at the assignability of any claims of the borrower in relation to the sellers.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

Commitment letters and acquisition agreements are not filed with any Spanish public registry, although they are normally formalised before a public notary, who would keep them in his or her files. The files are not accessible to the public, with the exception of parties or public authorities alleging and proving interest in their content.

In addition, when antitrust clearance is required, the acquisition agreements are filed with the antitrust authorities, who would make public the fact that the transaction is taking place, without giving information on the specific contents of the acquisition agreements. In public mergers and acquisitions, certain provisions of the acquisition agreements might need to be disclosed to the market, mainly if they include put or call options or restrictions on the sale of shares.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

As a general rule, once insolvency is declared, no enforcement actions can be initiated and those already started will be stayed. With reference to enforcement of security, this general rule only applies if such security has been granted over assets that are necessary for the insolvent to continue its business activity, but it also extends to enforcement even if insolvency has not been declared and provided that the debtor has informed the relevant court that it is in the process of negotiating an agreement for the refinancing of its debts or an anticipated creditors' agreement (the latter to be finally executed in the context of a judicial insolvency proceeding and following the relevant declaration of insolvency).

Within an insolvency proceeding, security over necessary assets can only be enforced once a creditors' agreement is approved (provided that its content does not affect the exercise of these enforcement rights), or after the first anniversary of the declaration of the insolvency (provided that the insolvent is not in the process of being liquidated). Within the referred period, security over necessary assets cannot be enforced, in order not to jeopardise the achievement of solutions that may lead to the debtor leaving its insolvent status.

This general regime does not affect financial collateral.

Due to the covid-19 crisis, several laws and Royal Decrees (among others, the most recent Royal Decree-Law 27/2021 of 23 November), introduced emergency legislation for insolvency proceedings on a temporary basis. Among other measures introduced:

- The debtor who is in a state of insolvency will not have the duty to file for an insolvency declaration until 30 June 2022. This does not prevent the debtor from filing for insolvency proceedings, nor does it remove directors' liability.
- For the purposes of the legal grounds for dissolution due to losses, losses for the financial years 2020 and 2021 shall not be taken into account.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Yes. Once the insolvency has been declared, any fresh money granted in favour of the insolvent within a creditors' plan of reorganisation will rank senior to any other financial creditor unless otherwise agreed under such agreement. This will also generally apply to 50 per cent of fresh money granted under a refinancing agreement executed prior to the declaration of insolvency and provided that such insolvency has not been finally avoided, despite the execution of the refinancing agreement. In this case, the other 50 per cent will only rank senior to other financial creditors whose claims are unsecured.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

As a general rule, once insolvency is declared, no enforcement actions can be initiated and those already started will be stayed. With reference to enforcement of security, this general rule only applies if such security has been granted over assets that are necessary for the insolvent to continue its business activity, but it also extends to enforcement even if insolvency has not been declared and provided that the debtor has informed the relevant court that it is in the process of negotiating an agreement for the refinancing of its debts or an anticipated creditors' agreement (the latter to be finally executed in the context of a judicial insolvency proceeding and following the relevant declaration of insolvency).

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Due to the covid-19 crisis, several laws and Royal Decrees (among others, Royal Decree-Law 27/2021 of 23 November, last in time), introduced emergency legislation for insolvency proceedings on a temporary basis. Among other measures introduced:

- The debtor who is in a state of insolvency will not have the duty to file for an insolvency declaration until 30 June 2022. This does not prevent the debtor from filing for insolvency proceedings, nor does it remove directors' liability.
- For the purposes of the legal grounds for dissolution due to losses, losses for the financial years 2020 and 2021 shall not be taken into account.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

Under Spanish law, acts detrimental to the insolvency estate carried out within two years prior to the declaration of insolvency can be clawed back, regardless of their fraudulent intention.

Any act or transaction will be presumed to be detrimental, without admitting evidence to the contrary, if it has been executed without consideration or if it involves payment of unsecured debts, the maturity of which was expected to take place after the declaration of the insolvency.

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Other acts or transactions that may be presumed to be detrimental, if no evidence to the contrary is submitted, include:

- the granting of security covering pre-existing obligations, or of new obligations substituting pre-existing ones; and
- payment of secured debts, the maturity of which is expected to take place after the declaration of insolvency.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

The Spanish Insolvency Act provides for the classification of claims into the following:

- special privileged claims (eg, secured claims with reference to the relevant secured assets) or general privileged claims (eg, labour, tax and social security claims);
- ordinary claims (eg, unsecured claims arising from financing agreements); and
- subordinated claims (eg, claims that qualify as subordinated by agreement of the parties and interest (the latter unless secured with an in rem security)).

The priority of payment directly depends on such classification.

Votes are allocated among the creditors depending on the amount of claims they hold. Affirmative votes required to approve a reorganisation plan directly depend on the content of the plan as follows:

- simple majority: if the agreement contemplates the payment in full of ordinary claims within a maximum of three years or the immediate payment of due and payable debts with no more than a 20 per cent reduction (haircut);
- creditors representing 50 per cent of the total debt: if the agreement includes haircuts of not more than 50 per cent of the total debt, or payment extensions of no more than five years, or both; or the conversion of claims into participative loans with a maturity of no more than five years; and
- creditors representing 65 per cent of the total debt: if the agreement contemplates haircuts of more than 50 per cent of the total debt, or payment extensions of between five and 10 years, or both; or the conversion of claims into participative loans with a maturity of between five and 10 years.

Due to the covid-19 crisis, certain emergency laws should be noted in relation to facility agreements from specially related persons to encourage business financing. Among others, it has been established that this type of claim will be considered as a claim against the insolvency estate (first in the ranking of claims). This will apply to cash revenues made from 14 March 2020 by persons specially related to the debtor. This measure may apply to insolvency proceedings declared up to 14 March 2022.

As a general rule, an agreement that involves the termination of the insolvency proceeding will not be binding on secured creditors, unless they vote in favour of the same (it is not mandatory for them to participate in the reorganisation agreement). The approval thresholds

referred to above will take into account ordinary claims only (and those of secured creditors who decide to vote in favour of it).

However, the agreement can be binding on secured creditors (financial creditors being considered as a separate class of creditor) if approval majorities are reached within their class, as follows:

- 60 per cent:
    - if the agreement contemplates the payment in full of ordinary claims within a maximum of three years;
    - the immediate payment of due and payable debts with no more than a 20 per cent reduction;
    - haircuts not exceeding 50 per cent or extensions not exceeding five years, or both; or
    - the conversion of claims into participative loans with a maturity of no more than five years; and

- 75 per cent in all other cases.

These percentages will be calculated on the value of the security (of creditors voting in favour over the total value of the security).

It should be taken into account that creditors who benefit from a personal guarantee issued by a third party may lose their claim against that third party (or have it limited) if they vote in favour of the reorganisation agreement, depending on the terms of the guarantee. Therefore, in Spain, it is common to include a provision under which the creditors voting in favour of a reorganisation agreement with the insolvent debtor will not alter the liability of the guarantor in any way.

Finally, the changes to the Insolvency Law approved in September 2022 significantly improve the ability of creditors to restructure debts prior to the insolvency, based on pre-insolvency restructuring plans (replacing the 'refinancing agreements' contemplated in the previous version of the law) which can be approved by the court and imposed on dissenting creditors (even secured creditors, commercial creditors and public law creditors) and the shareholders of the borrower. 'Pre-pack' insolvency proceedings, which are formally opened only to sell or liquidate the debtor or its productive units, are also contemplated now.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Contractual subordination is expressly recognised by the Spanish Insolvency Act to the extent that it does not involve fraud against other creditors.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

These will be treated as any other claims, calculated on the face value of the corresponding instrument.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

Two possible liabilities should be highlighted:

- if the security is constituted over necessary assets for the insolvent to continue its business activity, that security cannot be enforced until a creditors' agreement is approved (provided that its content does not affect the exercise of such enforcement rights), or after the first anniversary of the declaration of the insolvency (provided that the insolvent is not in the process of being liquidated); and
- the granting of security covering pre-existing obligations carried out within two years prior to the declaration of insolvency might be clawed back if no evidence that such granting of security is not detrimental to the insolvency estate is provided.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

As a result of financial aid allocated to Spain to boost recovery by means of the Next Generation EU plan, Royal Decree-Law 36/2020 of 30 December foresees a new type of Strategic Projects for Economic Recovery and Transformation (PERTE) entailing a public-private scheme formula that intends to have an impact in upcoming project finances, provided that the projects are strategic with a high capacity to drive economic growth, employment and competitiveness in the Spanish economy. The creation of a register of entities interested in PERTEs is envisaged to articulate these strategic projects. Royal Decree-Law 36/2020 of 30 December is subject to further regulatory development.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

In the case of Swiss target companies, acquisition agreements and related agreements are typically governed by Swiss law. Often, the debt finance documents for such transactions are also governed by Swiss law. Certain factors, such as the jurisdiction of the arrangers for a particular financing or if a financing is multi-layered in nature, may call for other laws to apply to certain debt finance documents. Equity and hybrid elements are generally governed by Swiss law (as the law of incorporation of the relevant entity).

As for the choice of a foreign law as the governing law of transaction agreements, the relevant Swiss conflict of laws rules generally permit this, subject to certain limitations. Foreign judgments and awards of foreign arbitral tribunals can be recognised and enforced in Switzerland, subject to certain requirements, limitations and procedures.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Generally speaking, Swiss law does not restrict acquisitions in Switzerland by foreign entities. Specific rules and requirements apply in certain regulated industries. For instance, the acquisition of a controlling stake in a Swiss bank by a foreign entity is subject to an additional permit and the satisfaction of certain requirements. We note that there are certain legislative efforts to introduce a stricter foreign investment control regime in Switzerland. A proposal is expected to become available during the first half of 2022.

Also, while not seen often in practice, it is possible that a Swiss target company has transfer restrictions in place that preclude or limit foreign entities from becoming shareholders in the company.

Where residential real estate is involved (including as part of the assets of a company), specific restrictions and requirements set out in the Federal Act on the Acquisition of Real Estate by Persons Abroad (known as Lex Koller) become relevant.

Regarding cross-border lending into Switzerland, there are, with the exception of the area of consumer credit, no specific restrictions. Certain restrictions may apply where security is taken over real estate assets.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

As in other jurisdictions, acquisitions in Switzerland are financed either by equity (or hybrid equity in the form of deeply subordinated shareholder loans) or by debt or, frequently, by a combination of equity and debt.

The structure of a debt package will typically vary as a function of, among other things, the required leverage.

Where low leverage is sufficient, the debt package will often consist of senior debt only. Such senior debt usually takes the form of a term loan. If, in addition to the acquisition loan, there are other financing needs, such as working capital needs, the senior lenders will often also provide a revolving credit facility.

Where higher leverage is sought, the senior debt may be increased by creating first lien and second lien senior debt, and junior debt is added on certain transactions. Such junior debt can consist of one or several layers (eg, mezzanine debt and high-yield debt) and it may provide for a payment-in-kind component, in addition to or in lieu of cash interest.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

In the context of public takeovers, Swiss law provides for 'certain funds' rules and requirements that must be complied with. Essentially, the offer prospectus must provide for financing details and a confirmation from a review body is required, confirming that the bidder has taken the necessary steps to ensure that the necessary funds will be available. The 'certain funds' requirements and provisions seen in the context of public takeovers in Switzerland are similar to international standards.

In the context of private transactions, there are no 'certain funds' requirements under Swiss law. In practice, there is wide variety in what parties negotiate in terms of funding certainty. Quite often, especially in the context of domestic transactions and where the seller and the acquirer are non-financial entities, parties work with a relatively low 'certain funds' threshold (eg, with a mere 'highly confident letter'). In larger transactions, and especially in transactions where private equity sellers are involved, 'certain funds' requirements are typically seen in practice and the threshold is typically a high one, often higher even than in the context of public takeovers.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Under Swiss law, there are no specific restrictions, but parties will very typically agree upon the permitted use of proceeds in the facility agreement.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

It is one of the core activities of many Swiss banks to provide financing to corporate borrowers. Yet, merely providing such financing does not by itself trigger a licensing requirement under Swiss banking laws. Rather, the licensing requirement is triggered only if the lender is refinancing itself by means of accepting deposits from the public or refinancing itself through a number of banks.

As far as cross-border lending is concerned, Swiss banking laws are based on the principle of territoriality (ie, lending into Switzerland on a strict cross-border basis is not, as a general rule and subject to certain exceptions, subject to licensing and supervision by the Swiss Financial Market Supervisory Authority). Usually, lending services are cross-border if the lender does not use or have recourse to physical infrastructure in Switzerland or personnel of its own in Switzerland for the purposes of its lending activities.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Under Swiss domestic tax laws, payments by a Swiss obligor under a bilateral or syndicated financing are, as a rule, not subject to Swiss withholding tax if the 'Swiss non-bank rules' are complied with.

These rules address, among other things, a potential tax recharacterisation of a borrowing that is not subject to Swiss withholding tax into a financing from the public that is subject to Swiss withholding tax. A Swiss withholding tax law issue is triggered where:

- a syndicate consists of more than 10 non-bank lenders (the 10 non-bank rule);
- a Swiss obligor has, on an aggregate level (ie, not on a transaction-specific level), more than 20 non-bank creditors (the 20 non-bank rule); or
- a Swiss obligor has, on an aggregate level (ie, not on a transaction-specific level), more than 100 non-bank creditors under financings that qualify as deposits within the meaning of the relevant rules (the 100 non-bank rule).

For these purposes, a 'bank' is essentially defined as a financial institution (Swiss or non-Swiss) that is licensed as a bank and that carries out genuine banking activities with infrastructure and personnel of its own.

A breach of the Swiss non-bank rules can result in Swiss withholding taxes becoming applicable (currently at a rate of 35 per cent). These taxes would have to be withheld by the Swiss obligor and may, based on any applicable double taxation treaty, be recoverable (in full or partially) by a lender.

Also, a standard gross-up clause may, in light of a prohibition in the Swiss Withholding Tax Act for a borrower to indemnify a lender for Swiss withholding tax, not be valid and enforceable in Switzerland, especially where the withholding tax is triggered as a result of a breach of any of the Swiss non-bank rules.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Other than in the area of consumer credit, there is no specific legislation on the maximum rate of interest that can generally be charged on a loan. However, excessive rates of interest are subject to the general Swiss law principles on usury. Under such principles, the maximum allowable rate of interest depends upon a number of factors and specific circumstances. There is no clear test or limit, but many practitioners believe that the limit would, in many circumstances, be in the range of approximately 15–18 per cent per year.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

In line with international standards, a borrower must typically indemnify its lenders for a breach of representations and covenants. In the context of acquisition financings, such representations and covenants tend to be quite comprehensive. In addition, one would typically see:

- tax indemnities;
- funding indemnities;
- currency indemnities and increased costs; and
- break costs regimes.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

Swiss law does not provide for any general restrictions on this. In practice, parties often agree in facility agreements that assignments of a lender's rights or transfers of its rights and obligations to a new lender are subject to the borrower's consent, apart from certain exceptions, such as if an event of default is continuing or if an assignment or transfer is

made to an existing lender or to an affiliate of an existing lender. In addition, assignments and transfers, as well as certain sub-participations and other risk exposure transfer transactions, must be made in compliance with the Swiss non-bank rules.

Requirements to act as agent or trustee

11 Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

These activities are not regulated activities under Swiss law, and Swiss law does not provide for specific rules governing them. In practice, these activities are typically exercised by licensed banks.

Debt buy-backs

12 May a borrower or financial sponsor conduct a debt buy-back?

Debt buy-back is not specifically regulated under Swiss law. Where debt buy-backs are addressed in finance documents (which is often the case in finance documents on leveraged transactions), parties generally prohibit or restrict such transactions or provide that the borrower's or financial sponsor's participation be disregarded when it comes to voting matters.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Swiss law does not specifically restrict a borrower from soliciting lenders' consent in the context of amendment requests. The relevant debt agreements will determine whether majority lenders' consent is sufficient or whether all lenders' consent is required for a particular amendment request.

With no contractual provisions to the contrary, Swiss law permits, in the authors' view, that majority requirements are solicited in a buy-back scenario, subject to compliance with general principles of law (eg, acting in good faith).

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

It is the prevailing view in Switzerland that the provision of upstream guarantees (ie, guarantees for obligations of direct or indirect shareholders of the guarantor) and cross-stream

guarantees (ie, guarantees for obligations of sister companies of the guarantor) is subject to a number of requirements and restrictions.

Essentially, it is held that these guarantees should be treated as the equivalent of a dividend distribution as far as formal and substantive requirements and limitations are concerned. The key implication of this is that upstream and cross-stream guarantees are, in practice, limited to the amount that the guarantor could distribute to its shareholders as a dividend at such time as payment is demanded under the guarantee. This limitation is sometimes referred to as the 'free equity limitation'. Also, payments under upstream and cross-stream guarantees may be subject to tax implications, including Swiss withholding tax.

Downstream guarantees (ie, guarantees for obligations of direct and indirect subsidiaries of the guarantor) are not typically subject to restrictions. Exceptions are possible under certain circumstances, for instance, if the subsidiary is not a wholly owned subsidiary of the guarantor or if the subsidiary is in significant financial distress.

As far as foreign entities are concerned, there are no specific limitations under Swiss law on the ability of such entities to provide guarantees for obligations of Swiss entities.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

The requirements and limitations applicable to upstream and cross-stream guarantees are also applicable to upstream and cross-stream security interests. That said, where a Swiss target provides guarantees and security interests for obligations of the acquirer (which will become the parent company of the Swiss target as a result of the acquisition), this Swiss security package would be upstream in nature and therefore subject to the various requirements and limitations, including a free equity limitation.

Swiss law does not provide for whitewash or similar procedures. A number of steps are taken in practice, however, to bolster the validity of an upstream security package and to mitigate, as far as possible, the imperfections of such security packages. The starting point is to make sure that the articles of association of the Swiss entity explicitly permit upstream undertakings. It is also important to ensure that the relevant transaction documents and the transactions contemplated are properly approved by the relevant corporate bodies. In addition, transaction documents will typically address the free equity limitation and certain Swiss withholding tax law points and they will also typically provide for certain undertakings and assurances by the security provider to mitigate, to the extent possible, the upstream limitations. Moreover, parties are typically advised, for corporate law and tax law reasons, to compensate the Swiss entity for the granting of the upstream security package by means of a guarantee or security fee.

Specific Swiss law issues can be faced where a Swiss target group company with minority shareholders is required to grant a guarantee or security interests for the obligations of the obligors under an acquisition financing. Such issues must be analysed and addressed on a case-by-case basis.

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Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Floating charges and blanket liens are not available under Swiss law. Such types of security interests are, among other things, not in line with the Swiss law requirements on the required level of specification of the collateral assets and they are also not typically in line with the Swiss law requirement that a security provider no longer be in possession of the collateral assets (in the case of movable assets).

In corporate lending transactions, the two most commonly used forms of security interests are the right of pledge and the security assignment or security transfer. Specifically, in the context of secured acquisition financing transactions, the Swiss security package often consists of a pledge over the shares in the Swiss target, a security assignment of certain receivables, a security assignment of rights and receivables under the acquisition agreements, a pledge over bank accounts and guarantees by certain entities. The scope of the security package may, of course, be narrower or broader, depending on the specifics of the transaction and, in particular, the specifics of the available assets.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

These matters are primarily governed by the Swiss Code of Obligations, the Swiss Civil Code and, in an international context, the Swiss Private International Law Act. Also, specific rules can be applicable for certain specific asset types (for instance, the Swiss Book-Entry Securities Act, where security is taken over book-entry securities).

Under Swiss law, the perfection requirements depend on the form of the security interest and on the type of collateral asset.

In general, a security interest over movable assets requires that the security provider give up possession of the relevant assets. Possession of such assets must pass to the secured parties or to a third party. This requirement does not apply to immovable assets and does not apply to movable assets for which there is a special register (in particular, ships and aircraft).

Notification is not, as a general rule, required under Swiss law to create a security interest, but it is required to prevent the underlying parties (eg, debtors under receivables assigned for security purposes) from validly discharging their obligations by means of payment to the security provider.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

There are no such requirements in Switzerland.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

No works council or similar consents are required to approve the provision of a guarantee or security interest by a Swiss company.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

It is possible under Swiss law that security is granted to, and held by, an agent, and security documents can be drafted such that it is not necessary to amend them upon a change of the secured parties. Where the security interest is a security assignment or a security transfer, the security agent can act in its own name for the benefit of the secured parties. Where the security interest is a right of pledge, it is necessary that the security agent act as direct representative of the secured parties (ie, in the name and on behalf of the secured parties). The reason for this is that a Swiss law pledge is accessory in nature, meaning, among other things, that the secured party must be identical to the creditor. This can be achieved by having the security agent act as a direct representative, which is the standard approach in Switzerland for accessory security interests (with exceptions for very specific transactions, where it can be necessary to adopt another approach). An alternative approach would be to create a parallel debt and to secure such parallel debt, as is done in many other jurisdictions. However, the concept of parallel debt remains untested in Switzerland. It is for this reason that the parallel debt concept is still not frequently used in Swiss security documents (at least not on a standalone basis).

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Not applicable.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

Swiss insolvency laws provide for clawback rules. In addition, Swiss insolvency laws provide that a creditor can request the court to open bankruptcy proceedings without prior enforcement proceedings against a debtor that acted fraudulently, or that is attempting to act fraudulently, to the detriment of its creditors.

In addition to the insolvency law rules, Swiss criminal laws provide that it is a criminal offence if a debtor reduces its assets to the detriment of its creditors if bankruptcy proceedings are commenced against it or if a certificate of unsatisfied claims has been issued.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

The documentation for acquisition financings varies, depending on, among other things, the size and structure of the particular transaction. Smaller transactions are often financed by a limited number of banks stepping in as senior lenders and the documentation for such transactions is often, especially where the borrower is a non-financial buyer, relatively straightforward. In such transactions, it is not uncommon in Switzerland, especially in domestic transactions, that parties work with a short-form debt commitment letter or even without a formal debt commitment letter but with a mere 'highly confident letter' of a bank. By contrast, in the context of larger acquisition financings, and especially in leveraged transactions and in cross-border transactions, the documentation is typically more complex and also frequently suitable for the international syndicated loan markets. In such transactions, it is not uncommon to see long-form debt commitment letters. In the context of public takeover transactions, parties typically sign the full documentation prior to the publication of the offer.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

Swiss market practice recognises both fully underwritten transactions and best efforts' transactions. In the context of acquisition transactions, it is fairly common to see fully underwritten financings. Also, in today's market, it is not uncommon for large banks to fully underwrite the financing for large transactions on a pure bilateral basis (with syndication efforts often starting after announcement only).

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

The set of conditions precedent in a debt commitment letter depends on the particular transaction. Quite often, in 'certain funds' financings, the conditions will include:

- that no major default has occurred or is continuing (major defaults being a subset of particularly important defaults as more fully set out in the full documentation);
- that no major representations and warranties have been breached (major representations and warranties being a subset of particularly important representations and warranties as more fully set out in the full documentation);
- that no major covenants have been breached (major covenants being a subset of particularly important covenants as more fully set out in the full documentation);
- that it is not unlawful for a lender to perform its obligations or to fund its participation; and
- certain other points (eg, no change of control, evidence that additional funds (eg, equity) are available to the borrower, copies of the signed acquisition agreements, and delivery of utilisation request).

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Where commitment letters are used it is not uncommon in Switzerland that parties work with a short-form debt commitment letter. Short-form debt commitment letters often do not set out market flex provisions. However, there is generally a mandate letter in place for such transactions and such mandate letters will often provide for market flex provisions. These provisions will typically entitle the arrangers to increase the interest margin, increase certain fees, or change other terms or the structure of the facilities. These rights are typically drafted such that the arrangers can only exercise them where they, in good faith, determine them to be necessary. Parties sometimes also agree on a cap that any such changes are allowed to fall within. In recent years, borrowers have been able to negotiate in a number of transactions (including very large financings) that the commitment papers do not include flex provisions.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

This is not frequently seen in Switzerland.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

Lenders typically want to make sure that they are not obliged to fund if the bidder is not obliged to close the acquisition transaction. Attention is therefore paid, among other things, to the drafting of the material adverse change provisions in the acquisition documents, on the one hand, and the finance documents on the other hand. In addition, lenders will typically want to have an 'out' in the finance documents if a material adverse change occurs in relation to the bidder, if a change of control occurs in relation to the bidder or if certain other draw-stop events occur.

As regards liability protection afforded to lenders in acquisition agreements, such provisions are relatively uncommon in Switzerland. Parties generally take sufficient comfort from making sure that the seller is not party to any of the finance documents and that the finance documents are drafted such that the seller does not have a legal basis for a claim against the banks. On the rare occasion that this is not viewed as giving sufficient comfort, banks seek the inclusion of specific liability protection in acquisition agreements.

In finance documents, one would typically see waiver of liability provisions and indemnity provisions for the benefit of the lenders.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

Commitment letters do not have to be and are not publicly filed in Switzerland and do not, as a matter of law, have to be made public. The same holds true for acquisition agreements, with exceptions for specific transactions for which the agreements must be filed with the commercial register. In asset transactions, registration requirements exist for certain assets. Finally, as in other jurisdictions, merger control provisions and filing requirements exist under Swiss competition law. Special rules apply in the context of public takeover transactions.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

In bankruptcy proceedings, creditors secured by means of a pledge must submit the respective collateral to the bankruptcy administration and are not entitled to realise the collateral privately, but will be satisfied, before any other creditors, out of the net enforcement proceeds

of the sale of such collateral. This holds true for all movable assets that have been pledged to the secured party, rather than transferred or assigned for security purposes.

Additional exceptions to the above-mentioned principle apply to intermediated securities that are traded on a representative market. In turn, real estate mortgages are only realised and proceeds paid out to the creditors if their claims against the debtor are due; claims secured by real estate mortgages that are not yet due are assigned to the acquirer of the real property.

In composition proceedings leading to a composition agreement with assignment of assets, secured creditors with a pledge on movable assets are not obliged to deliver the collateral to the liquidator. After the moratorium, they are generally entitled to liquidate the pledged collateral by official enforcement proceedings or, if the pledge agreement so provides, by private sale.

Debtor-in-possession financing

31 | Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Swiss law does not provide for a specific financing instrument for companies in financial distress. Nevertheless, a Swiss entity that is in financial distress may, as an alternative to an application for bankruptcy, seek a composition with its creditors and apply for a moratorium while negotiations are ongoing. Whereas an entity would be dissolved at the end of bankruptcy proceedings, composition proceedings aim to restructure the debts of the debtor. New liabilities incurred by the debtor with the administrator's consent during such a moratorium will be separated from the pre-existing creditors' claims and will be satisfied first before the payment of percentage dividends or liquidation proceeds under a settlement agreement. The administrator's consent will only be given if the rights of the existing creditors are not jeopardised. This privilege will also be maintained if the company is adjudicated bankrupt at a later stage. Secured claims are not subject to the composition agreement, except for such part of the secured claim that may remain unsatisfied after realisation of the collateral.

Stays and adequate protection against creditors

32 | During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

Under Swiss debt enforcement law, the opening of bankruptcy proceedings leads to the cessation of all other enforcement proceedings against the debtor, and new enforcement proceedings for claims that arose before the declaration of bankruptcy are not permissible.

Upon the opening of bankruptcy proceedings, all obligations of the debtor (except for claims secured on real estate) become due immediately. The realisation of assets is reserved to the bankruptcy administrator. Secured creditors will be satisfied first, before any other creditors, out of the net enforcement proceeds of the relevant collateral.

Whereas bankruptcy proceedings lead to the dissolution of the debtor, it is a key rationale of composition proceedings to either facilitate the dissolution of the debtor by applying a more flexible procedure than in bankruptcy proceedings or to restructure the debts of the debtor.

In general, there are two different procedural stages of composition proceedings: the stage of a (definite) moratorium; and the stage after the composition agreement has been concluded among the creditors and approved by the competent court. In addition, the competent court may appoint a temporary administrator and grant a temporary moratorium of up to two months as preliminary measures before it decides on the opening of composition proceedings.

During a definite moratorium, creditors of claims other than first-class claims or claims that are secured by real estate are not entitled to commence or continue debt enforcement proceedings and the periods of limitation and peremptory deadlines do not run. In any event, realisation of collateral is not permitted during a moratorium. This not only affects enforcement proceedings with the assistance of debt enforcement authorities, but also private realisation of collateral. After the moratorium, creditors are generally entitled to liquidate collateral by official enforcement proceedings for the realisation of collateral or, if the security agreement so provides, by private sale.

As mentioned above, secured claims are satisfied directly from the net enforcement proceeds of the relevant collateral. If several security interests exist in the same property, they are ranked in chronological order of establishment, or in the case of 'register assets' (eg, real estate), as indicated in the relevant register.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

Swiss insolvency laws provide for clawback rules. Broadly speaking, under such rules, certain arrangements or dispositions made by the insolvent during a period (suspect period) preceding the declaration of bankruptcy or the grant of a moratorium may be clawed back in bankruptcy proceedings. This potential challenge relates to:

- donations and dispositions made by the debtor without any or without adequate consideration within a suspect period of one year;
- the granting of a security interest for existing debts, if the debtor was not, by prior agreement, contractually obliged to create the relevant security interest, the payment of a claim in a manner other than by the usual means of payment and the payment of a debt that was not yet due, provided the debtor was over-indebted when the disposition was made and further provided that the disposition took place within a suspect period of one year; and
- dispositions made by the debtor within a suspect period of five years, if the disposition was made with the intent to prefer one creditor to the detriment of other creditors and if the privileged creditor knew or should have known of such intent.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

Under Swiss law, claims of creditors are satisfied in a specific order. Secured claims are satisfied directly out of the net enforcement proceeds of the relevant collateral. Debt incurred by the bankruptcy or liquidation estate or during a debt restructuring moratorium with the administrator's consent ranks above unsecured claims. Unsecured claims are satisfied out of the proceeds of the remainder of the bankruptcy estate. There are three classes of unsecured claims. The first class consists of, inter alia, certain claims of employees as well as claims of pension funds. The second class consists of claims regarding various contributions to social insurances and tax claims. All other claims are ranked in the third class. Creditors for such claims only get paid after all privileged claims are satisfied in full.

A Swiss corporation in financial distress may, as an alternative to an application for bankruptcy, seek a composition with its creditors and apply for a moratorium while negotiations are ongoing. Approval of a composition agreement by the creditors requires the affirmative vote of either a majority of creditors (headcount) representing two-thirds of the total debt that is subject to the composition agreement or a quarter of the creditors (headcount) representing three-quarters of the total debt that is subject to the composition agreement. In addition to creditors' approval, a composition agreement also requires confirmation from the composition court. Once court confirmation has been obtained, a composition agreement becomes binding upon all creditors whose claims are subject to the composition agreement, whether or not they have participated in the composition proceedings.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

Swiss law recognises agreements addressing lien priorities. A distinction is made between security interests in relation to assets for which there is a register (register assets) and assets for which there is no register. For register assets (in particular, real estate, ships and aircraft), the ranking of the security is determined by the rank in the relevant register. This rank is agreed between the parties at the time the security interest is granted. However, parties cannot agree on a ranking that would affect the security of a third party whose rights are already entered in the register, unless the third party agrees. To be effective, any agreed new ranking must again be entered in the register. For security over non-register assets, the ranking of security is determined by the chronological order in which the security interests were granted (time priority concept). Parties can, however, agree on a different ranking among themselves.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

In the absence of precedents, it is the authors' view that the claim made in an insolvency of a Swiss issuer of such an instrument could be the full amount of the instrument but discounted for the remaining duration of such instrument.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

As a general point, where a secured creditor enforces against collateral in a manner that is not commercially reasonable (or not in line with applicable statutory or contractual rules, or both), this may open up a risk of claims for damages.

Also, specific liabilities can arise, for instance, in connection with real estate, namely, where a secured creditor forecloses into real estate assets and becomes the legal owner of the real estate asset.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

It is worth noting that the majority of new bank loans provide for (some sort of) a sustainability-link (typically via a KPI or KPIs) and that market practice on a number of points in this regard is starting to settle.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

Acquisition and finance documents in the United Kingdom are most commonly governed by English law (or the law of England and Wales) as opposed to Scottish or Northern Irish law, as the other territories of the United Kingdom have their own laws. There is no such thing as 'UK law'. High-yield bond documentation will be governed by New York law, following the custom in that market. If a loan deal adopts high-yield style covenants, the credit agreement may provide that those covenants are to be construed in accordance with New York law (although the obligation to comply can nonetheless still be governed by English law – contracts that actually split the governing law can be problematic from an enforcement perspective).

English courts will generally recognise and give effect to the choice of a foreign law to govern the terms of a contract. This is in line with article 3.1 of Rome I Regulation ((EC) No. 593/2008), which, following the United Kingdom's exit from the European Union (Brexit), has been adopted into domestic law by virtue of the Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc) (EU Exit) Regulations 2019. However, there are circumstances where this will not be the case or that rule is overridden.

Following Brexit, the Brussels Regulation (Council Regulation (EC) 44/2001) and the Recast Brussels Regulation (Regulation (EU) No. 1215/2012), which governed the allocation of jurisdiction and the reciprocal enforcement of judgments between EU member states and Denmark, have ceased to apply as between the United Kingdom and the EU. Proceedings initiated before the end of the transition period (on or before 31 December 2020) are still subject to the EU jurisdictional regime. Proceedings issued after the end of the transition period (from 1 January 2021) are subject to the 2005 Hague Convention on Choice of Court Agreements (the 2005 Hague Convention) and English common law rules. The 2005 Hague Convention broadly requires the courts of the United Kingdom to uphold exclusive jurisdiction clauses nominating the courts of a Hague Convention state. Under the common law regime, jurisdiction is generally founded on service of process. English courts will generally accept jurisdiction if the proceedings can be served on a defendant within the jurisdiction, if there is an English non-exclusive jurisdiction clause or based upon one or more common law jurisdictional gateways.

For certain foreign judgments that fall outside the 2005 Hague Convention or common law rules there are additional statutes (eg, the Administration of Justice Act 1920, which recognises the enforcement of judgments in most commonwealth countries and British overseas

territories, and the Foreign Judgments (Reciprocal Enforcement) Act 1933, which applies to judgments from courts in Australia, Canada (except Nunavut and Quebec), Guernsey, India, the Isle of Man, Israel, Jersey and Pakistan) that may ensure that foreign judgments are recognised.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

Until recently, there were no real legal or regulatory impediments to foreign entities acquiring English incorporated entities, other than customary antitrust regulation, sanctions regimes and approvals in respect of regulated industries. However, the National Security and Investment Act 2021 (the NSI Act), which came into effect on 4 January 2022, has introduced wide powers to investigate and block foreign acquisitions of English companies and certain assets on the basis of national security. The NSI Act extends to a broad range of sectors that are deemed strategically sensitive, including defence, artificial intelligence, robotics and transport.

The acquisition of public companies in the UK is regulated by the City Code on Takeovers and Mergers (the Takeover Code), which controls how and when a public offer must be conducted. The acquisition of companies that are regulated (eg, under the Financial Services and Markets Act 2000 (FSMA)) may also require approval from the relevant regulator (eg, the Financial Conduct Authority (FCA)).

In respect of cross-border lending activity, authorisation is required under the FSMA to carry out certain regulated activities, such as accepting deposits or making loans to individuals including consumer mortgage loans. Corporate lending is generally not subject to FSMA consents or licences.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

An acquisition financing will typically involve a newly formed special purpose vehicle (SPV), funded by a mixture of debt and equity. Equity may be made available to the SPV by means of share subscription or subordinated shareholder loans. The choice or split between pure equity and subordinated shareholder loans will be determined by tax considerations.

Third-party debt financing can take the form of loans or bonds. There may be several layers of debt that are ranked in terms of priority (both in terms of payment and security). There could be senior loans with a combination of second lien debt, mezzanine debt, payment in kind debt at the holding company level and high-yield bonds beneath it, or there could be just senior debt (including senior secured high-yield bonds), or maybe senior or unitranche debt alongside a super senior revolving credit facility.

The appropriate method of debt financing an acquisition depends on many factors, including, but not limited to, the size and creditworthiness of the buyer target, the availability and quality of security that can be given, the amount of money required, the ability to structure the debt within the group in a tax-efficient manner and liquidity in the relevant debt market.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

Yes – the Takeover Code (rule 2.7) applicable to acquisitions of public companies requires 'certain funds'. The offeror must ensure it can fulfil any cash consideration, and must have every reason to believe that it will continue to be able to fulfil the cash consideration, when an offer is made. A financial advisor must also provide a 'cash confirmation' to give additional comfort that the cash consideration will be paid.

While not required by law, it has become common market practice for private acquisitions to have no 'financing out', meaning that well-advised buyers (and sellers) will require certain funds financing commitments to ensure that the buyer will have the financial wherewithal to complete the transaction (albeit that in the private context a cash confirmation from a financial advisor will not be required).

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

The use of proceeds will be prescribed by a purpose or use of proceeds clause. In the case of an acquisition financing the purpose usually includes funding the purchase price, refinancing any outstanding debt of the buyer or target and financing or reimbursing any associated fees, costs and expenses. Any related revolving credit facility will likely be available for working capital or general corporate purposes.

Otherwise there are not typically any prescribed or prohibited uses of proceeds save that there may be sanction or anti-bribery related covenants that will not permit proceeds to be used in a manner that will breach sanction or anti-bribery laws.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Corporate lending by itself is not a regulated activity in the UK and therefore there are no requirements to hold a licence when making a loan to an English company.

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Withholding tax can be applicable to interest payments that have a UK source for UK tax purposes. The current rate is 20 per cent. Certain exemptions may be available to the requirement to withhold; however, the availability of such exemptions will be transaction-specific and may also depend on completion of administrative formalities.

Where withholding tax is applicable, the borrower is responsible for deducting the applicable tax from any UK source interest payment it makes. Should withholding tax become applicable as a result of a change of law after the time the recipient became a lender, it is common for the loan terms to require the borrower to 'gross up' those payments to take account of any withholding, so that the recipient continues to receive the amount they were expecting to receive as if there was no withholding. However, lenders that are not entitled to an exemption at the time they become a lender are not typically entitled to a gross-up.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

There are no usury or similar restrictions on the amount of interest that can be charged on corporate loans that are governed by English law, save that in certain circumstances transactions requiring high rates of interest could be vulnerable to avoidance claims as an extortionate transaction under section 244 of the Insolvency Act 1986. In addition, terms of a document providing for the payment by a party of any additional amount (including interest) as a consequence of a breach or default may be held to be unenforceable on the grounds that it is a penalty if it imposes a detriment which is out of all proportion to the legitimate interest of the innocent party.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

A typical suite of indemnities will cover costs and expenses incurred in connection with documenting the transaction, amendments to the finance documents and preservation or enforcement of rights in connection with the finance documents. There will also likely be indemnities granted in respect of taxes, stamp duty, increased costs, break costs, broken funding costs, investigation of defaults and receiving payments in different currencies. Lenders and creditors will also provide indemnities for any liabilities incurred by facility and collateral agents in performing their roles.

Assigning debt interests among lenders

10 | Can interests in debt be freely assigned among lenders?

Interests in debt can be freely assigned as a matter of English law. While bonds are typically freely tradeable, loan agreements will often require borrower consent to an assignment, unless such assignment is to another lender or an affiliate or related fund of an existing lender or if the assignee is on a pre-approved list. The occurrence of an event of default (or increasingly the occurrence of a specified list of material events of default) will also typically provide an exception to the consent requirement. Assignments to competitors or distressed investors can also be expressly prohibited and assignees for undrawn facilities may be required to have a minimum credit rating.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

Trust and agency concepts are recognised under English law and it will be typical for either one of the banks (if the financing is provided by a bank or banks) or an independent third-party provider to act as facility agent (ie, administrative agent) and security agent or trustee (ie, collateral agent). There are no licensing or regulatory requirements for entities to perform the typical facility agent and security agent or trustee roles; however, in practice the banks and many independent agency or trustee providers may be registered with the FCA.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Yes. Credit agreements will typically include controls and parameters around this to ensure equality of treatment among lenders. Buy-backs by borrowers of loans will typically result in the debt being extinguished and will often only be permitted to be funded from certain sources. Buy-backs by sponsors will also be permitted provided that, unless the entities buying the debt are independent debt fund affiliates, the sponsors holding the debt will be largely disenfranchised for voting purposes and will not be entitled to participate in lender meetings.

Exit consents

13 | Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Ostensibly yes: English law-governed credit agreements can be amended with the consent of the majority lenders (typically 66 and two thirds per cent or increasingly more than 50 per cent following the US model). However, changes to key economic terms will often require unanimous or at least affected lender consent, namely, the consent of each lender that is affected by the proposed amendment; and in certain circumstances an English court may uphold a challenge to a consent passed by the requisite majority if they conclude that the consent constitutes an oppression on the minority or an abuse of power.

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GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no costs or taxes in the UK that are applicable to the provision of a guarantee in respect of the obligations of another company in the same group.

Subject to financial assistance restrictions and, if the company operates in a regulated industry, any regulatory controls that might exist, any guarantee provided by an English company must be in the best interests of that company and promote the success of that company for the benefit of its members. This will typically be memorialised in board or shareholder resolutions. Another consideration is whether or not the guarantee would reduce the net assets of the company providing the guarantee and therefore potentially constitute an unlawful distribution as an English company must have sufficient distributable reserves in order to be able to make a distribution to shareholders.

There are no limitations under English law on foreign-registered related companies providing guarantees on both a secured and unsecured basis, but local law restrictions may apply.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

Subject to limited exceptions, the Companies Act 2006 imposes prohibitions on financial assistance in the context of the acquisition of shares in a public company and in the context of the acquisition of shares in a private company if the private company has a public company subsidiary that is providing financial assistance.

Financial assistance includes the giving of guarantees or security, gifts or loans made by the target company to assist with the acquisition. In the UK, financial assistance by an English company in respect of the acquisition of shares in a foreign holding company would not be subject to the financial assistance rules.

Financial assistance restrictions only apply to companies that are public companies at the time such assistance is given. It is possible and common, therefore, to re-register a public company as a private company to enable it and its subsidiaries to give financial assistance for the acquisition of its shares.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

English law permits all asset security agreements commonly referred to as debentures to be entered into. An English law debenture will typically contain a mixture of security interests: mortgages (over real property), security assignments (over receivables and certain contracts), fixed charges (over certain specified asset categories) and a floating charge over all the assets and undertaking of the chargor. An English law debenture will be set up to cover future acquired assets and will include perfection steps for those future assets such as notices, delivery of title documents and similar requirements. In the case of the acquisition of real property, if a legal mortgage is to be granted over such assets then a new mortgage will need to be granted as it is not possible to create a legal mortgage over after-acquired real property.

It is common to exclude from the all asset security certain assets that the chargor is not able or is not permitted to grant security over. There may be other exclusions to reflect what is commercially agreed as being the security package.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

In England, there is not (for example) an equivalent of the Uniform Commercial Code in the US. Rather, perfection of security occurs, depending on the type of security interest and asset, through registration at applicable registries and delivery of notices and acknowledgments. In general, most charges and mortgages created by an English company must be registered with Companies House within 21 days of the date of the creation of the security interest. Failure to register results in the security being void as against other creditors in a liquidation or administration and will also result in the debt it secures becoming immediately due and payable. Security interests over certain classes of assets (such as land, intellectual property rights, ships or aircraft) should be registered on specific title registers. Otherwise, counterparties and other legal owners of the relevant assets must be given notice of security to preserve priority over subsequent security.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

In general, once a security is registered at the applicable registry (and provided the registration is completed correctly) there is no need to renew the registration for the particular asset or creditor in respect of which the registration was made.

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

No – unless a company has entered into contractual arrangements that would require it (which would be unusual) there would be no requirement to obtain consents, or consult with, any works council, trade union or other employee or equivalent representative body for the provision of guarantees or security by an English company.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Under English law a security agent can hold security over the borrower's assets on behalf of multiple lenders. The security agent will usually be appointed to hold the benefit of the security on trust for the lenders. As such, existing lenders can assign or transfer their interest under the facility, and the incoming lender, subject to complying with the requisite transfer formalities, should be able to benefit from the existing security and guarantees without amending the underlying documents.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

There are no particular creditor protections before security can be released under English law. The release of English law security will typically be documented by a deed of release. The underlying security document may provide that if the payment that has been made to discharge the debt is subsequently clawed back then the released security will be reinstated.

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

Under section 423 of the Insolvency Act 1986, transactions can be set aside at an under-value (see also 'Clawbacks' below for further details) if they have the effect and purpose of defrauding creditors. This could be by way of either: (1) putting assets beyond the reach of a person who may, at some time, be entitled to make a claim against the person transferring the asset; or (2) otherwise prejudicing the interest of such person in relation to the claim they are entitled to make. Section 423 has a broad application and there is no requirement that the debtor be insolvent or in any formal insolvency proceedings for relief to be sought.

Whether the 'purpose' test has been met is a subjective question and the burden of proof is placed on the claimant. There is no prescribed time limit specified for bringing a claim under this section (barring the usual statutory limitation periods) and certain bodies (including the Financial Conduct Authority) are also permitted to bring an action under this section.

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DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

In a typical certain funds acquisition financing the suite of commitment documentation will consist of: commitment letter, term sheet, fee letter, syndication letter (if a syndicated deal and syndication or flex terms are not covered in the fee letter), mandate letter (mandating the bond takeout if the financing package includes a bridge to bond) and interim facilities agreement (an abbreviated form of bridge loan agreement that may be used if long-form documentation has not been agreed prior to closing). Long-form documentation is not strictly required, although some market participants prefer long-form documents in place of an interim facilities agreement. Since most acquisition financings will call for 'certain funds' commitments to be in place when the relevant purchase agreement is signed, most if not all relevant conditions precedent will also have been satisfied or at least be in agreed form.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

In an acquisition finance context, commitment letters will typically need to provide for fully underwritten commitments on a 'certain funds' basis, namely, with very limited conditionality.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Conditions precedent in a commitment letter for an acquisition financing will typically be limited to illegality, a limited suite of 'certain funds' drawstops and limited documentary conditions precedent such as constitutional documents, corporation authorisations, formalities and closing certificate, executed finance documents and legal opinions. The commitment letter will typically also confirm sign-off on the commercial conditions precedent, namely, the form of acquisition agreement, the due diligence reports, tax structure memorandum, financial statements for the target and all know your customer requirements.

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Yes, if the underwriters intend to syndicate their commitments, market flex provisions will be included in the fee letter or sometimes a separate syndication letter. Market flex provisions will typically allow the underwriters to increase margin or fees in order to make the

commitments more attractive to prospective participants, up to an agreed cap. There may also be specific terms that have been underwritten but that can be changed to again make the overall package more attractive to prospective lenders. The scope of the list of terms that can be changed is negotiable on a case-by-case basis but will often include items like: debt, restricted payment or investment capacity; most favoured nation (MFN) terms; alteration or removal of step-downs in margin ratchet or prepayment requirements; and EBITDA add-backs.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

A securities demand will be a key feature in an acquisition financing where all or part of the term debt is in the form of a bridge loan that bridges to a high-yield bond. The securities demand will require that if takeout bonds have not been issued by a certain point, the proposed issuer will be forced to issue securities on pre-agreed terms. As to what these terms are, and crucially what the coupon for those securities will be, is subject to negotiation (and anticipated market conditions at the time).

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

A lender will want to understand the long-stop date and associated conditions that must be met before closing can happen as this will determine how long a lender's commitments will need to be available. Any financing cooperation language should ensure the lenders will receive sufficient assistance from the target to assist with any syndication or fundraising process they would like to undertake ahead of closing. Finally, the assignment provisions will be reviewed to make sure that they permit the taking of security over the purchaser's rights under the acquisition agreement.

Provisions that protect against lender liability (ie, 'Xerox provisions') are not needed in English law purchase agreements but they are nonetheless sometimes included where US-based parties are involved.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

There is no requirement to make acquisition agreements or commitment letters public save that finance or offer documents are required to be made public in the context of a public takeover where the City Code on Takeovers and Mergers (the Takeover Code) is applicable.

Rule 24.3 of the Takeover Code requires that certain details about the terms of the financing are included in the offer document and that the finance documents themselves must be publicly available by no later than 12pm on the business day following the bidder's announcement of a firm intention to make an offer.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

As a contractual matter, lenders will need to respect the enforcement trigger in the finance documents, whether that is the occurrence of an event of default or the taking of additional steps or giving notice. In taking enforcement action, there may also be prescribed procedures and requirements set out in the security documents or intercreditor agreement, or in the applicable law. Lenders enforcing security (or more likely the security agent on their behalf) will also need to ensure that the legal duty to obtain the best price reasonably obtainable is complied with or else risk liability to other creditors or the debtor. This will typically result in a marketing or at least valuation exercise being undertaken before enforcement action is undertaken.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

No, UK legislation does not support DIP financing. A form of DIP financing may occur in insolvency scenarios as an administrator or liquidator has the power to borrow and such borrowings will have super priority ahead of creditors secured by a floating charge. A fixed-charge holder will still maintain their priority over the fixed security and an administrator can only sell assets that are subject to a fixed charge with the consent of the fixed-charge holder.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

If a debtor goes into administration a statutory moratorium takes effect that: (1) prevents the issuing or continuation of proceedings against the debtor (including alternative insolvency proceedings); and (2) prevents the enforcement of security by a creditor against the debtor. In certain circumstances, a debtor may also benefit from an interim moratorium before it enters administration. This will be the case where a notice of intention to appoint administrators over a debtor is filed, or an application to appoint administrators is made.

Security interests that constitute a financial collateral arrangement under the Financial Collateral Regulations 2003 (as amended and incorporated into English law) are exempted from the statutory moratorium. If voluntary liquidation of a debtor is commenced, there is

no automatic stay on enforcing security; however, related parties can apply to the court for a moratorium to be imposed.

There is no concept under English law that is equivalent to adequate protection.

Outside of formal insolvency processes, the Corporate Insolvency and Governance Act 2020 introduced a standalone moratorium procedure for companies (aside from insurance companies, banks, electronic money institutions, investment banks and firms and parties to capital market arrangements) in financial distress looking to facilitate a rescue plan. This can be initiated by the directors of the debtor making a court filing. Once approved, the period of the moratorium will last 20 business days. However, this can be extended for another 20 business days and further extensions are permitted with creditor consent or the consent of the court. Companies already subject to an insolvency procedure and those that have been in a moratorium, company voluntary arrangement or administration in the previous 12 months are not eligible.

The moratorium can only be used where it is likely that it will result in the rescue of the debtor as a going concern.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

The Insolvency Act 1986 provides that certain transactions will be vulnerable to being unwound.

Transactions at an undervalue entered into within two years prior to the onset of insolvency can be challenged under section 238 of the Insolvency Act 1986 if, at the time the transaction was made, or as a result, the debtor was unable to pay its debts and certain defences provided under section 238(5) do not apply. A transaction at an undervalue is one whereby a debtor: (1) made a gift or otherwise entered into a transaction on terms that the debtor received no consideration; or (2) entered into a transaction for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the debtor. If the transaction was with a connected party, there is a presumption that the debtor was unable to pay their debts at the time the transaction was made. A defence is available under section 238 if it can be shown that the transaction was entered into in good faith for the benefit of the debtor and that there were reasonable grounds to believe that the transaction would benefit the debtor.

Transactions that constitute a preference, in other words which place creditors in a better position than they otherwise would be in the event of the debtor going into an insolvent liquidation, are also liable to being set aside (section 239 of the Insolvency Act 1986). For such transactions to be set aside, they must have occurred within six months (or two years for connected parties) prior to the onset of insolvency. The debtor must also have been unable to pay its debts at the time of the transaction, or as a result of entering into the transaction, and in entering the transaction the debtor must have been influenced by a desire to prefer the relevant creditor.

The grant of a floating charge may also be invalidated (section 245 of the Insolvency Act 1986) if granted within 12 months (or two years for connected parties) prior to the onset of the debtor's insolvency and (unless granted to a connected party) the debtor was unable to pay its debts at the time of the transaction, or as a result. If new consideration was provided for the floating charge, for example, by way of a new advance of funds, then that can provide a defence to a claim under section 245. This 'new money' consideration requirement can also extend to the advance of goods and services supplied to the debtor at the same time as, or after, the creation of the charge, but this will be a question of degree.

Extortionate credit transactions (section 244 of the Insolvency Act 1986) are ones that require exorbitant payments to be made (whether unconditionally or in certain contingencies) in exchange for credit or that grossly contravene principles of fair dealing. The vulnerability period for such transactions is three years.

There are also other common law rules, such as the anti-deprivation rule, which can be applicable to certain transactions. These rules are designed to ensure that assets are not put beyond reach of creditors in an insolvency and that the rules on how assets are to be distributed on an insolvency are not frustrated. These rules typically do not capture normal commercial arrangements within their scope.

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

In an insolvency, the priority of claims is complex but, generally speaking, they will rank as follows:

- costs of preserving and realising the fixed charge assets (including the office holder's costs relating to those assets);
- fixed charge creditors;
- priority pre-moratorium debts and moratorium debts;
- costs and expenses of the office holder;
- preferential creditors (eg, unpaid wages of employees and pension contributions);
- secondary preferential creditors (eg, unpaid VAT and PAYE income tax owed to HMRC);
- payments to unsecured creditors from the prescribed part (calculated as a percentage of the value of the debtor's property that is subject to floating charges, subject to a cap of £800,000);
- floating charge creditors;
- unsecured creditors; and
- shareholders of the debtor.

Plans of reorganisation in the UK are divided into two main categories: schemes of arrangement (implemented via Part 26 of the Companies Act 2006) and restructuring plans (implemented via Part 26A of the Companies Act 2006). Both procedures require sanction by the court. These are standalone processes, but can be utilised within formal insolvency proceedings, although this is rare.

In each scenario, creditors are divided into classes for voting purposes. A class of creditors will generally be those creditors whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest (eg, secured lenders will form a separate class to unsecured creditors).

A scheme of arrangement will be approved by the consent of each class of creditors voting in favour, with a statutory majority of 75 per cent in value and a majority in number of each class present and voting being required. Assuming these thresholds are met (and the court sanctions the scheme), any dissenting creditors will also be bound.

Voting in a restructuring plan is similar in that 75 per cent in the value of the class present and voting is required to vote in favour (but no majority in number is required). However, some notable differences exist between a restructuring plan and a scheme of arrangement:

- a restructuring plan is only available where a debtor encounters or is likely to encounter financial difficulties that are affecting, or will or may affect its ability to carry on business as a going concern and the purpose of the restructuring plan is to eliminate, reduce, prevent or mitigate the effects of, any of the debtor's financial difficulties; and
- the restructuring plan features a cross-class cram-down. This means that the plan may be sanctioned by the court even if not every class approves the plan, provided that the plan is approved by one 'in the money' class and the court is satisfied that none of the members of the dissenting classes would be any worse off than they would be in the relevant alternative.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

English courts ought to recognise contractual subordination arrangements provided they do not contravene any competing insolvency laws or public policy.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

There are no particular concerns or issues with respect to OID claims under English law.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

As well as potential liability if steps are not taken to obtain the best price reasonably obtainable, creditors could also potentially incur liability as mortgagee in possession with respect to environmental claims that might arise in connection with real property.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

We have continued to see the phasing out of LIBOR from use in sterling and dollar-denominated financings, with LIBOR being replaced by Sterling Overnight Index Average or Secured Overnight Financing Rate (as applicable) based interest rates instead. Environmental, social and governance (ESG)-linked financings have also been in the ascendency, with many more financings having the benefit of margin ratchets based on attaining improvement in certain key performance indicators or ESG ratings.

The Economic Crime (Transparency and Enforcement) Act (the Act) introduced requirements on foreign owners of property in the UK. The key developments are:

- all non-UK entities that own or acquire real property in the UK will need to register the entity's beneficial owners at Companies House by 31 January 2023;
- the requirement to register will apply retrospectively, from 1999 in England and Wales and from 2014 in Scotland; and
- failure to comply will result in (1) limitations in subsequent transfer or security rights, as well as (2) criminal sanctions for the entity and its officers.

Failure to comply with the requirement to register could result in restrictions on the ability to transfer or charge the land, or to grant a lease of more than seven years, unless the overseas entity is exempt. An overseas entity seeking to purchase, lease or grant security over UK property from now on will need to have registered at Companies House before completing its acquisition or financing. Beneficiaries of security over real property in the UK owned by a non-UK entity, will therefore want to ensure that the entity's beneficial owners have complied with their requirements to register under the Act.

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Summary

GENERAL STRUCTURING OF FINANCING

Choice of law

1 What territory's law typically governs the transaction agreements? Will courts in your jurisdiction recognise a choice of foreign law or a judgment from a foreign jurisdiction?

The most common choice of US law for credit agreements and bond indentures is the law of the State of New York, and most broadly syndicated acquisition financings are governed by New York law.

Where an acquisition agreement is governed by the law of a state other than New York (for instance, many merger and acquisition agreements are governed in whole or in part by Delaware law), acquisition financing commitments will agree that the satisfaction of the conditions precedent in the merger or acquisition agreement (for example, that the acquisition has closed in accordance with the terms of the applicable agreement) will be interpreted in accordance with the law governing the acquisition agreement (in this case, Delaware), but require that all actions against or involving the financing sources or the acquisition financing commitment be brought in a New York court (with any matter involving the acquisition financing itself being interpreted in accordance with New York law).

New York courts will generally give effect to a choice of New York law in any contract involving in excess of $250,000, whether or not the parties thereto have any reasonable relationship to the State of New York, pursuant to section 5-1401 of the New York General Obligations Law.

New York courts will generally give effect to an express choice of non-US law in a contract, unless the chosen jurisdiction has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or application of the law of the chosen jurisdiction would be contrary to a fundamental policy of another jurisdiction (which may include the State of New York) that has a materially greater interest than the chosen jurisdiction.

New York courts will also generally recognise as valid and enforce a final and conclusive judgment granting or denying the recovery of a sum of money, other than judgments for taxes, fines or other penalties, rendered by a non-US court that is enforceable under the laws of the relevant non-US jurisdiction, without re-examination of the substantive issues underlying the judgment pursuant to the Uniform Foreign-Country Money Judgments Recognition Act, as adopted in 2021 in the State of New York (article 53 of the New York Civil Practice Law and Rules). However, New York courts will not enforce judgments rendered under a system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law or which did not have personal jurisdiction over the defendant. In addition, New York courts may decline to recognise judgments obtained by

fraud, judgments under causes of action deemed repugnant to New York public policy, judgments issued by courts that did not have subject-matter jurisdiction, judgments where the defendant did not receive sufficient notice, judgments conflicting with other final judgments, judgments in situations where the parties had an agreement to settle the matter outside of a court, judgments where jurisdiction was based solely on personal service and the foreign court was a seriously inconvenient forum, and defamation judgments in jurisdictions that do not provide at least as much freedom of speech and press protections as provided under the US and New York constitutions.

Restrictions on cross-border acquisitions and lending

2 Does the legal and regulatory regime in your jurisdiction restrict acquisitions by foreign entities? Are there any restrictions on cross-border lending?

In most cases, US law does not restrict acquisitions by foreign entities or cross-border lending. Such acquisitions and loans are routine. In certain industries and areas deemed sensitive, however, acquisitions and investments by foreign persons and entities may be subject to review under US federal law, particularly national security laws that are reviewed by the Committee on Foreign Investment in the United States. There also are restrictions and enhanced reporting that apply when there is foreign ownership in certain industries (eg, airlines, broadband licences and wireless satellite networks, banking and nuclear power) and of certain assets such as real property.

In addition, all acquirers, borrowers, guarantors and lenders (foreign or domestic) are required to comply with applicable anti-money laundering, sanctions and anti-corruption laws.

Types of debt

3 What are the typical debt components of acquisition financing in your jurisdiction? Does acquisition financing typically include subordinated debt or just senior debt?

Acquisition financings in the United States take multiple forms, depending on the size of the transaction and the relative availability of different forms of debt.

In investment grade transactions, most acquisition financing is in the form of unsecured bank loans (often this is in the form of bridge loans, which are intended to be replaced relatively quickly by a subsequent issuance of unsecured and less costly notes or long-term unsecured bank loans) or unsecured notes.

In non-investment grade transactions, including private equity-led buyouts, the debt component will often include senior secured term loans arranged by bank or non-bank arrangers that are syndicated to institutional investors. These senior secured term loans also may be divided into first- and second-lien tranches, which may be syndicated to different groups of institutional investors. In middle-market transactions, term loans may be incurred as a unitranche facility, where the lenders provide the borrower a single-tranche term loan and agree among themselves as to the division of economics, including the priority of payments

and collateral proceeds. In many middle-market deals (and increasingly in large-cap transactions), the lenders are not banks and the loans are not syndicated.

In addition, non-investment grade acquisition financings may also include notes issued to investors via either a registered securities offering or, more commonly, a private placement under Rule 144A under the Securities Act of 1933. Such notes may be senior secured (and vary in terms of lien priority), senior unsecured or subordinated. Because the successful placement of a note offering is never certain, buyers will customarily obtain bridge term loan commitments from one or more arrangers in an aggregate amount up to the expected proceeds of the contemplated note offering. Where the note offering is partially or (in rare cases) completely unsuccessful, the bridge term loan will be funded at the closing of the acquisition to make up the shortfall in debt capital available to the buyer to consummate the acquisition. Such bridge commitments are expected by sellers, to eliminate any adverse impact, including an inability to consummate the acquisition, from a less-than-completely successful note offering prior to closing.

Mezzanine financing (eg. subordinated debt, which may have an equity component) is also found in middle-market and smaller acquisition financings, but it is a less common component of larger acquisition transactions and there is quite a bit of variation in economic and covenant terms.

Typical acquisition financing packages also will include a revolving credit facility, which may be in the form of either an asset-based lending facility or a secured or unsecured cash-flow revolving credit facility; a cash-flow revolving credit facility will often be documented in the same credit agreement along with the term loan facility. Such facilities may be unsecured in investment-grade transactions or may be secured by all assets on an equal (pari passu) basis to the senior secured term loan or on a senior basis to other financing (such as a second-lien term loan). In an asset-based lending revolving credit facility, the facility will be secured by a first-priority lien on specific assets, such as receivables or inventory. In a situation where acquisition financing has both an asset-based lending facility and secured term loans, there will typically be crossing liens, where the term loans will be secured on a first-priority lien on assets not securing the asset-backed facility.

Certain funds

4 Are there rules requiring certainty of financing for acquisitions of public companies? Have 'certain funds' provisions become market practice in other transactions where not required?

The concept of certain funds provisions (as understood in the United States) in acquisition financing commitment documentation has been widely adopted for public and private target companies. However, there are no rules or laws that require the inclusion of certain funds provisions in acquisition financing commitment documentation. Instead, a combination of sellers insisting on greater deal certainty and buyers wanting both deal certainty and to provide sellers with assurance that the buyer will have the financing needed to consummate the acquisition on the specified closing date has created an expectation that certain funds provisions will be included. In practice, almost all acquisition financings where there is an executory period between the signing date of the acquisition agreement and the closing date are consummated on a certain funds basis.

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It is important to note that the concept of certain funds in the United States is different from the highly regulated concept of certain funds in the United Kingdom and other European jurisdictions. In the United States, certain funds typically consist of what is known as 'SunGard conditionality', in which the conditions precedent to the closing of the acquisition financing are linked as closely as possible to the conditions precedent to the closing of the underlying acquisition. Specifically, this includes limiting the representations and warranties that are required to be accurate as a condition to funding the acquisition financing to (1) the representations in the acquisition agreement about the target business, which if not true would permit the buyer to terminate the acquisition (such as the absence of a material adverse effect), and (2) certain fundamental representations in the credit agreement, which if not true the lenders would be unwilling or unable to fund the acquisition financing (such as the valid existence of the borrower and solvency upon consummation of the acquisition and related financing). Other conditions precedent are limited to a relatively small set of market-accepted items, such as the delivery of certain audited and unaudited financial statements and the taking of limited actions for perfecting security interests. There is no requirement for confirmation of funds from a financial adviser.

Notably, most US acquisition agreements provide that the requirement to consummate the acquisition is subject to there not having been a material adverse change or material adverse effect (the exact terms and definitions thereof are highly deal-specific and carefully negotiated in each transaction) with respect to the target company, at the signing of the acquisition agreement and at closing. This condition is essentially duplicated without change in the related acquisition financing commitments. Ensuring that any such condition in the commitment documentation exactly mirrors the acquisition agreement language is crucial for the borrower. In addition, most US financing commitments are subject to the negotiation of definitive documentation. Sophisticated parties have limited the related conditionality through specifying precedent documents and detailed term sheets, but the concept of an interim facility agreement has not gained much, if any, traction.

Restrictions on use of proceeds

5 Are there any restrictions on the borrower's use of proceeds from loans or debt securities?

Most credit agreements and note purchase agreements restrict the use of debt proceeds to enumerated items, which in the case of acquisition financings ordinarily includes the purchase price for the acquisition, any related refinancing, and associated fees and expenses. In the case of working capital facilities, borrowers typically are limited to using proceeds for general corporate purposes or working capital purposes, which are generally viewed as encompassing all legitimate uses of such proceeds by the borrower and its subsidiaries.

In addition, most credit agreements and note purchase agreements provide that the borrower and its subsidiaries may not use the proceeds of the loans in violation of any sanctions, anti-money laundering or anti-corruption laws (in addition to containing requirements that the borrower comply with all other relevant laws). Moreover, margin regulations promulgated by the Federal Reserve Board limit the use of borrowed money for purposes deemed to involve the purchase or carrying of 'margin stock' – broadly defined to include all publicly traded equity securities, as well as securities convertible into publicly traded equity

and related options – including, in many cases, debt secured by liens on margin stock. As a result, many credit facilities exclude margin stock from collateral granting clauses. Loans that are to be secured by margin stock require careful regulatory analysis to ensure compliance with the margin regulations.

Licensing requirements for financing

6 What are the licensing requirements for financial institutions to provide financing to a company organised in your jurisdiction?

Various US federal and state regulations apply to financial institutions seeking to provide financing in the United States. As may be expected, these regulations are most stringent with respect to banks based in the United States and foreign banks seeking to operate in the United States. The most prominent national bank regulators are the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation, which share responsibility for regulating national banks. In addition, individual state-chartered banks are regulated by state banking regulators. Foreign banks seeking to operate in the United States must obtain a licence from a state regulator or the OCC, depending on the scope of services they wish to provide.

A large and increasingly important portion of acquisition financing in the United States is provided by non-bank arrangers and lenders, such as hedge funds, pension funds, commercial finance companies and affiliates of private equity sponsors. These institutions are not regulated in the manner of traditional banks (though there may be licensing requirements in certain states, and certain direct lenders are subject to securities regulations, exchange rules or other regulatory framework, depending on their sources of capital).

Withholding tax on debt repayments

7 Are principal or interest payments or other fees related to indebtedness subject to withholding tax? Is the borrower responsible for withholding tax? Must the borrower indemnify the lenders for such taxes?

Payments by US borrowers to US lenders are not subject to withholding taxes.

Payments of interest (but usually not principal) by US borrowers to non-US lenders are subject to a 30 per cent withholding tax (payable by the borrower) unless the payments are subject to an exception to withholding. The most-commonly relied upon exceptions are the portfolio interest exemption (which is generally available where a lender delivers a valid certificate of its status as a non-US person to the borrower, is not the holder (or deemed holder) of 10 per cent or more of the equity of the borrower and is not carrying on a US trade or business) and the existence of a tax treaty between the United States and the jurisdiction where the relevant lender is domiciled that provides the lender with an exception to withholding. Most lenders rely on the portfolio interest exemption; however, non-US banks are not eligible for the portfolio interest exemption, and must rely on a tax treaty or, more commonly, establish and lend through a US branch.

Most US credit agreements provide that any withholding tax liability that exists on the closing date of the relevant loan is borne by the lender subject to that liability. Similarly, lenders

that enter into loans by assignment are responsible for withholding liability that exists on the date of the assignment. However, if new withholding taxes are imposed as a result of a change of law after the closing date (or the date of assignment), the borrower is required to gross up the lender such that the interest payment the lender receives is the same as it would have been absent the change of law.

Restrictions on interest

8 Are there usury laws or other rules limiting the amount of interest that can be charged?

Usury is governed by state law. There is no federal usury law.

New York's usury statute provides that loans in an amount of $2.5 million or more are exempt from its civil and criminal usury statutes. Loans below $2.5 million (but above $250,000) are subject to a criminal usury cap of 25 per cent per annum.

Indemnities

9 What kind of indemnities would customarily be provided by the borrower to lenders in connection with a financing?

In credit agreements, the borrower typically indemnifies the agents, lenders and their respective affiliates and representatives against all losses, claims, damages and expenses of any kind (whether brought by the borrower or a third party) arising from or relating to the loan documentation, the use of proceeds of the loans, any investigation or litigation in connection with the loan documentation or any other matter related to the making or administration or enforcement of the loan. Typically, the indemnity excludes matters arising from the gross negligence, bad faith or wilful misconduct of the indemnified party and material breaches by indemnified parties of the loan documentation, in each case as determined by a court of competent jurisdiction in a final, non-appealable judgment, as well as claims among indemnified parties (other than claims against an agent in its capacity as such). Such indemnities generally include reimbursement for out-of-pocket expenses (including attorneys' fees, which are often limited to reasonable fees of one firm of lead counsel (and assorted special and conflicts counsels) for all similarly situated indemnified parties).

Holders of debt securities do not typically receive indemnities from the issuer. Trustees in note indentures typically receive indemnity from issuers consistent with (or sometimes even broader than) that provided to agents in credit agreements.

Assigning debt interests among lenders

10 Can interests in debt be freely assigned among lenders?

Loans in syndicated credit facilities are typically assignable, subject to a limited number of requirements, including:

- the assignment must be for more than a minimum amount (unless it is made to an affiliate or related fund of the assignor or is the full amount held by the assignor);

- the assignee must be 'eligible', meaning that it must not be a natural person, a defaulting lender (typically, an existing lender that has breached an obligation under the loan documents or has encountered insolvency difficulty of some sort), the borrower or one of its subsidiaries (unless required to retire the debt) or a disqualified lender (typically, a competitor or the business or an entity that is listed on a disqualified institutions list provided by the borrower on the closing date and updated thereafter);
- unless the assignee is an existing lender or an affiliate (or certain related fund) of an existing lender, so long as no event of default (sometimes this will be limited to no payment or bankruptcy event of default or other subset of events of default) has occurred and is continuing, the consent of the borrower (and sometimes the administrative agent, especially in the case of assignments of revolving loans) is required (for the borrower, consent is not to be unreasonably withheld or delayed, with any non-response for more than a specified period of days being deemed consent); and
- entry into an assignment and assumption agreement, which must be delivered to the administrative agent for recordation in its records (sometimes called a 'register').

Notes that are issued in a registered offering are generally freely transferable. Most acquisition financings are privately placed, however, and require transfers to be made in accordance with specific exemptions under the Securities Act of 1933, including the ability to transfer notes to Qualified Institutional Buyers, which encompasses most active participants in the high-yield bond market.

Requirements to act as agent or trustee

11 | Do rules in your jurisdiction govern whether an entity can act as an administrative agent, trustee or collateral agent?

There are no specific rules governing administrative agents or collateral agents under New York or federal law.

Indenture trustees are governed under US securities laws, including the Trust Indenture Act of 1939, and must meet specific requirements set forth in that statute. In practice, there is a relatively small number of established indenture trustees (consisting of banks and non-bank entities) that act as trustee on the vast majority of note transactions.

Debt buy-backs

12 | May a borrower or financial sponsor conduct a debt buy-back?

Most credit agreements provide borrowers and sponsors with the ability to purchase loans, subject to significant limitations.

In the case of borrowers, lenders are generally required to be repaid on a pro rata basis and at par. Credit agreements often provide, however, that the borrower may purchase term loans (which must be cancelled following purchase) on a non-pro rata basis for less than par pursuant to a Dutch auction made available to all lenders. Credit agreements will also commonly also allow borrowers to make open-market purchases of their term loans from individual lenders at prices to be negotiated on a bilateral basis.

In sponsor-led deals, the sponsor and its affiliates are usually permitted to purchase and hold up to a specified percentage of the outstanding term loans through Dutch auctions or open-market purchases. Term loans held by the sponsor and its affiliates are typically ignored in lender votes (with some exceptions, including in the case of adverse disproportionate treatment) and the sponsor is not entitled to attend lender meetings or receive lender-only information. These limitations typically do not apply to bona fide debt funds affiliated with the sponsor that are not under common day-to-day management with its private equity arm, although there may be some limitations on voting.

With respect to debt securities, issuers and their affiliates are generally able to purchase securities on the open market (but such securities may not be counted in holder votes) on a bilateral basis. Larger purchases, however, especially if a general solicitation is intended, must often comply with the tender offer rules promulgated under the Securities Exchange Act of 1934.

Exit consents

13 Is it permissible in a buy-back to solicit a majority of lenders to agree to amend covenants in the outstanding debt agreements?

Typically, there are no restrictions on exit consents in credit agreements or note indentures. Certain exit consents have come under increased scrutiny to the extent a subset of holders is disadvantaged vis-à-vis other holders. Most operating and financial covenants can be amended or deleted with simple majority consent (though important exceptions exist and each desired amendment must be analysed under the terms of the relevant agreement).

GUARANTEES AND COLLATERAL

Related company guarantees

14 Are there restrictions on the provision of related company guarantees? Are there any limitations on the ability of foreign-registered related companies to provide guarantees?

There are no restrictions on the ability of US entities to guarantee the obligations of related entities, other than any restrictions that would otherwise apply to debt incurrences by such guarantor entities or limitations on fraudulent transfers. To the extent that such guarantees are secured, standard filing fees and recording taxes may be payable, but these are not different from those that would be payable if the guarantor were providing security for its own debt (and not a guarantee).

Guarantees and grants of liens by foreign subsidiaries in support of the indebtedness of US borrowers may trigger tax consequences under the US Internal Revenue Code, although tax law changes have, in some cases, reduced or eliminated the negative effects of such actions for certain US corporate borrowers. Specifically, foreign subsidiaries that guarantee parent company debt may be deemed, for the purpose of federal taxation, to have paid a taxable dividend to the parent company in an amount equal to the greater of the earnings and profits of such subsidiary and the amount of debt guaranteed. Because no funds would

actually have been repatriated in such a transaction, a deemed dividend may result in tax liabilities to the parent company without the parent company having actually received any cash. The law provides a safe harbour that allows pledges of less than two-thirds of the voting equity (and 100 per cent of the non-voting equity) of first-tier foreign subsidiaries, but does not allow any guarantees by, or any liens on, the assets of such entities or any indirect foreign subsidiaries. Despite the aforementioned tax law changes, most US acquisition financings continue to not require guarantees or collateral from foreign entities beyond the safe harbour equity pledges.

Assistance by the target

15 Are there specific restrictions on the target's provision of guarantees or collateral or financial assistance in an acquisition of its shares? What steps may be taken to permit such actions?

No. US law is extremely flexible in allowing targets to guarantee and provide collateral for acquisition financing and the norm is for such support to be provided. No whitewash or similar procedure is required.

Types of security

16 What kinds of security are available? Are floating and fixed charges permitted? Can a blanket lien be granted on all assets of a company? What are the typical exceptions to an all-assets grant?

Blanket liens on personal property – which is the general term for assets other than real property and includes accounts receivable, inventory, intellectual property, debt and equity securities, money, bank accounts, brokerage accounts, equipment, fixtures, contract rights, commercial tort claims, letter of credit rights and general intangibles and goods (a catch-all terms for other personal property not included in the foregoing list), as well as proceeds thereof – are permitted in the United States. The norm in secured acquisition financings is for borrowers and guarantors to grant liens on substantially all of their assets as collateral for their obligations. As there is no distinction between fixed and floating charges on personal property in the United States, grants of security over personal property security routinely cover both presently owned and after-acquired assets.

The creation of a security interest in most forms of personal property is governed exclusively by state law, typically the Uniform Commercial Code (UCC). While the terms of the UCC vary slightly among states, it is, for the most part, uniform, with the UCC of each state permitting the creation of a valid security interest in personal property using a security agreement entered into under the laws of any other state (so long as such security agreement contains a clear description of the collateral, is signed by the grantor and contains a provision granting a security interest in the collateral to the secured party). Therefore, only a single security agreement (usually governed by the same state law as the related credit agreement) is required to create security interests in all UCC-governed personal property owned by a borrower and any guarantors in the United States. For perfection of a security interest in most kinds of personal property, the state law governing the security agreement typically will point to the terms of the UCC as adopted in the state where the obligor or property is located as the governing law.

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In transactions where an all-assets lien is granted, typical exclusions to the grant of collateral include:

- assets where a security interest requires the consent of a third party (including the issuer of any equity interests or any other holder of equity interests of such entity) or governmental agency;
- assets as to which a security interest would violate applicable law or binding contracts;
- deposit accounts containing funds held for the benefit of third parties;
- subject to changes in tax laws referenced above, equity interests in foreign subsidiaries (other than up to 65 per cent of the voting interests (and 100 per cent of any non-voting interests) in any foreign subsidiary directly held by a US entity);
- assets that require cumbersome perfection procedures in relation to their value, such as motor vehicles, aircraft, ships and railcars (depending, in each case, on the importance of such assets to the overall collateral package); and
- equity interests in certain non-guarantor subsidiaries.

Security interests in real property are also governed by state law, but there is significant variation among the states in the required terms of a real property mortgage (or, in some states, a deed of trust) and the laws applicable thereto. Generally speaking, the creation of a lien on real property is accomplished by having a mortgage or deed of trust executed by the grantor (that is, the property owner) and the secured party, which is then recorded with the local (usually county-level) recording office. Lenders and borrowers will typically hire local counsel (sometimes to be shared by the parties) in each jurisdiction where real property collateral is located to navigate local requirements. The time period for perfecting security interests in real property may be negotiated to take into account any local requirements.

Requirements for perfecting a security interest

17 Are there specific bodies of law governing the perfection of certain types of collateral? What kinds of notification or other steps must be taken to perfect a security interest against collateral?

Perfection of security interests in most forms of personal property is generally governed by the Uniform Commercial Code (UCC) as adopted in each state. The UCC generally provides that such security interests over most personal property may be perfected by filing a UCC financing statement naming the debtor and secured party and providing a general description of the collateral with the appropriate state filing office. In the case of grants of collateral by corporations and similar entities formed in the United States, the appropriate filing office is that of the state of incorporation or formation of the relevant grantor.

Perfection of security interests in copyrights (and, by custom, patents and trademarks) requires filing with the US Copyright Office (or the US Patent and Trademark Office), in accordance with federal law. For perfection of security interests in deposit accounts, the UCC requires that either the secured party is the relevant depositary bank or that the secured party, grantor and the depositary bank enter into an agreement granting 'control' (as such concept is understood under the UCC) over such deposit accounts to the secured party. Various state and federal laws govern perfection of security interests in motor vehicles, aircraft, ships and railcars, with separate registries and perfection steps required for such categories. Mortgages in real property are perfected by recording such mortgages (or

equivalent documents) with the local (usually county-level) recording office where the real property is located.

In addition to the perfection steps with respect to personal property described above, the UCC grants priority to liens in certificated securities and certain other investment property that are perfected by the delivery of such items (together with signed instruments of transfer) into the possession of the secured party. Consequently, such delivery is a required step in most US transactions for certificated securities and certain other investment property.

Renewing a security interest

18 Once a security interest is perfected, are there renewal procedures to keep the lien valid and recorded?

Generally, the perfection of a security interest by filing a financing statement under the UCC in each state is valid for a term of five years from the initial filing date. If a security interest is to remain in effect for longer than five years, a continuation statement must be filed prior to the lapse of the existing filing. Typically, such a filing is made during the six months preceding the fifth anniversary of the initial filing date. It should be noted that a change in the name of the grantor or its jurisdiction of incorporation or formation will require the timely filing of an amendment financing statement (for a different name) or new financing statement (for a new jurisdiction) for the security interest to remain perfected.

Other forms of perfection (such as control or possession) generally remain in effect indefinitely (though state laws may differ in certain cases with respect to non-UCC governed property).

Stakeholder consent for guarantees

19 Are there 'works council' or other similar consents required to approve the provision of guarantees or security by a company?

The United States does not have any equivalent of a works council. Ordinarily, only the consent of the board of directors or similar governing body of the guarantor or grantor would be required to provide a guarantee or security. Unlike the United Kingdom, the consent of an entity's shareholders or other equity holders is typically not required for the entity to provide a guarantee or security.

Granting collateral through an agent

20 Can security be granted to an agent for the benefit of all lenders or must collateral be granted to lenders individually and then amendments executed upon any assignment?

Yes. Security is commonly granted to a single agent (either an administrative agent or collateral agent) or trustee in US financings. Such common security is held for the benefit of all lenders and, if applicable, other 'secured parties'.

Creditor protection before collateral release

21 What protection is typically afforded to creditors before collateral can be released? Are there ways to structure around such protection?

Most credit agreements and indentures allow releases of collateral in connection with permitted dispositions of collateral. Release of collateral that is not permitted to be disposed of typically require the consent of an agreed percentage of the lenders or noteholders. The release of all or substantially all of the collateral typically requires the consent of all lenders or, in some cases, a substantial majority thereof.

In the case of secured notes, the Trust Indenture Act of 1939 (TIA) may be implicated in releases of collateral. It is common to structure secured notes as second lien or otherwise junior in right of security, so that releases of collateral may be approved by the first lien lenders and binding on the second lien noteholders and trustee

Fraudulent transfer

22 Describe the fraudulent transfer laws in your jurisdiction.

The US Bankruptcy Code provides that a transfer (which includes the incurrence or guarantee of indebtedness, the granting of a lien and the transfer of assets) may be avoided if it occurred within two years of the filing of a bankruptcy petition and the debtor, voluntarily or involuntarily:

- made such transfer with actual intent to hinder, delay or defraud any creditor; or
- received less than a reasonably equivalent value in exchange for such transfer or obligation; and

    - was insolvent on the date that such transfer was made or became insolvent as a result of such transfer;
    - such transfer resulted in the debtor having unreasonably small capital to engage in its business; or
    - the debtor intended to incur, or believed that it would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

Each state also has its own fraudulent transfer laws, which may also be applied in bankruptcy proceedings, and which generally include longer look-back periods (typically as long as four years) than the Bankruptcy Code.

For many states, these fraudulent transfer laws may be based on the Uniform Fraudulent Transfer Act (UFTA) or the more recent Uniform Voidable Transactions Act (UVTA), which endeavoured to address certain issues that had been identified in or arisen under the UFTA. New York a few years ago adopted the UVTA and, as such, the voidable transactions law in New York now varies only slightly from the law adopted in most other states.

DEBT COMMITMENT LETTERS AND ACQUISITION AGREEMENTS

Types of documentation

23 What documentation is typically used in your jurisdiction for acquisition financing? Are short-form or long-form debt commitment letters used and when is full documentation required?

Acquisition financing documentation can be divided into components required upon signing of the acquisition agreement and those required upon the closing of the acquisition.

At the signing of the acquisition agreement, the financing documentation typically consists of:

- a commitment letter pursuant to which the signatory lenders commit to provide the financing and which governs the syndication process, indemnities and confidentiality provisions, among other things;
- term sheets attached to the commitment letter detailing the economic and other terms of the loans, including representations and warranties to be made, covenants and exceptions and events of default, and specifying the conditions precedent to funding;
- one or more fee letters, setting forth the fees payable and often including flex provisions and, if a securities offering is contemplated, securities demand provisions; and
- in transactions that contemplate a securities offering, an engagement letter setting forth the terms of such offering (including fees payable and credits available in connection therewith).

The definitive documentation for the acquisition financing is typically not prepared until after the acquisition agreement has been signed. Parties rely on the terms of the commitment letter (including any provisions setting forth an agreed precedent and 'ground rules' for the definitive documentation) for comfort that the final documentation will be prepared in time for closing.

At the closing of the acquisition, the acquisition financing documentation generally would include:

- one or more credit agreements;
- related security and guarantee agreements, pledge agreements and other ancillary agreements;
- an intercreditor agreement in a transaction with different classes of creditors; and
- in a notes transaction, a purchase agreement, indenture, relevant security and guarantee agreements, if any, and notes.

Level of commitment

24 What levels of commitment are given by parties in debt commitment letters and acquisition agreements in your jurisdiction? Fully underwritten, best efforts or other types of commitments?

The vast majority of acquisition financing commitments are fully underwritten at the insistence of both buyers and, especially, sellers. Anything less than a binding commitment for

100 per cent of the needed financing is unlikely to be acceptable. Although best efforts commitments do exist, they are not typically used in acquisition financings because of the risk that no financing will be available upon closing.

Conditions precedent for funding

25 What are the typical conditions precedent to funding contained in the commitment letter in your jurisdiction?

Common conditions precedent in acquisition financings include the following:

- completion of the acquisition in accordance with the acquisition agreement, without any waivers or amendments to the acquisition agreement that are adverse to the lenders without consent (which is often required not to be unreasonably withheld);
- accuracy of the representations in the acquisition agreement that are material to the interests of the lenders (to the extent that the failure of such representations to be accurate would allow the buyer to decline to close the transaction);
- delivery of a solvency certificate stating that the combined company is solvent after giving effect to the acquisition and incurrence of the financing;
- that no material adverse effect has occurred with respect to the target company (the wording of this condition precedent and the definition of 'material adverse effect' will be the same as that in the acquisition agreement);
- obtaining any required equity financing and other debt financing to complete the transaction;
- repayment of any debt not permitted to exist following the closing;
- delivery of agreed financial information, including audited and pro forma unaudited financial statements;
- delivery of signed loan documents, certificates and legal opinions;
- delivery of required know your customer information;
- payment of all fees and expenses borne by the borrower;
- in secured deals, perfection of liens, including delivery of any required securities certificates (limited by 'certain funds' provisions);
- provision of a marketing period or an 'inside date' prior to which the transaction may not close; and
- in notes deals, provision of necessary marketing documentation (or information necessary to prepare such documentation).

Flex provisions

26 Are flex provisions used in commitment letters in your jurisdiction? Which provisions are usually subject to such flex?

Market flex provisions are common in broadly syndicated loans, as they allow the borrower to press the market for aggressive terms, while permitting the commitment parties to provide more lender-favourable terms in situations where such adjustments are deemed necessary to ensure a successful syndication (normally defined as the arrangers and their affiliates holding $0 of the term loan). These terms are highly negotiated, vary significantly from deal to deal and are among the most closely guarded trade secrets of the arranging entities. Common provisions subject to market flex include pricing, sunsets of most favoured nation

provisions, covenant baskets, prepayment requirements, prepayment premiums and length of term. In contrast, there is no flex (or syndication) for direct lending deals.

Securities demands

27 Are securities demands a key feature in acquisition financing in your jurisdiction? Give details of the notable features of securities demands in your jurisdiction.

Securities demand provisions are common in acquisition financings including debt securities. In such transactions, because of the complexity of placing debt securities, arrangers typically provide a bridge commitment consisting of an agreement to make term loans to the buyer on the closing date of the acquisition in an amount equal to the expected proceeds of the proposed securities issuance. While the bridge loans are not intended to be funded, they provide both seller and buyer comfort that a failure to place all of the anticipated the debt securities between signing of the acquisition agreement and the closing of the acquisition will not result in the buyer being unable to pay the acquisition consideration.

Because lenders are typically loath to fund a bridge facility, they reserve the right to compel the buyer to issue debt securities to the lenders, either to fund the acquisition instead of borrowing bridge facility loans or quickly replace the bridge facility loans that were borrowed to fund the acquisition. This right is usually exercisable by the lenders either at closing (or, rarely, prior to closing in the form of an escrow funding) or for a period after closing (to refinance a funded bridge facility), which is usually one year, in one or more (subject to a cap) separate demands. The relevant demand provisions will specify whether such debt securities are to be registered or privately placed and the overall nature of the debt securities (though the terms of demand securities are often similar to the terms of the bridge facility they are replacing with respect to security and ranking). Customarily, demand provisions limit the pricing of such securities to an agreed total cap on yield and set forth the expected range of maturity dates and economic features (such as call protection and minimum issuance amount per demand), as well as other material terms of the securities.

Key terms for lenders

28 What are the key elements in the acquisition agreement that are relevant to the lenders in your jurisdiction? What liability protections are typically afforded to lenders in the acquisition agreement?

In most acquisition financing commitments, because some of the conditions precedent (namely, the 'no material adverse effect' condition and the accuracy of representations and warranties condition) are based on or mirror certain parts of the acquisition agreement, and also because the lenders expressly agree that the acquisition agreement is acceptable to them, lenders are careful to review those conditions precedent and a few other provisions in the acquisition agreement. Some areas of focus are the representations regarding the acquisition financing and the covenants that the buyer will maintain its financing commitments and will act to obtain the financing on the terms set forth therein in time for the closing of the acquisition. The provisions of acquisition agreements that require the seller and target to cooperate with the buyer in connection with the financing, and the inclusion of a marketing period or inside date (ie, a date prior to which the acquisition may not close), are

also important to lenders, as the expectation is that the loans (or notes) will be syndicated (or placed) during the period between signing of the acquisition agreement and the closing of the acquisition, which requires the assistance of the seller and target in most cases, as well as sufficient time to market the debt.

In addition, lenders typically insist on lender-protective 'Xerox provisions' in acquisition agreements. These provisions specify that all actions arising under the acquisition agreement involving the lenders will be maintained in the jurisdiction and using the choice of law (usually New York) specified in the financing commitment letter, even if the acquisition agreement specifies different choices; trial by jury is waived by all parties in such actions; the lender is expressly exempt from liability to the seller or target (and that any provision limiting recourse to a reverse breakup fee payable by the buyer also protects the lenders); and the foregoing provisions may be enforced by, and may not be amended without the consent of, the lenders.

Public filing of commitment papers

29 Are commitment letters and acquisition agreements publicly filed in your jurisdiction? At what point in the process are the commitment papers made public?

Commitment letters and acquisition agreements are only made public in transactions where the buyer or seller is a public reporting company and the transaction is required to be disclosed in accordance with US securities laws. In the case of acquisition agreements, if the transaction is sufficiently material to warrant disclosure, either buyer or seller or both may publicly file the acquisition agreement with the Securities and Exchange Commission (SEC). Commitment letters are not viewed to be material agreements with respect to a seller (as the seller is not a party) but, in situations where they constitute a material agreement of the buyer, the buyer would file the commitment letter and term sheet (but not any associated fee letter or engagement letter, which may include sensitive deal terms) with the SEC.

Material acquisition agreements are typically filed with the SEC promptly following the entry into such agreements pursuant to a filing on Form 8-K, which also includes a description of the relevant transaction. The Form 8-K might also disclose entry into a material commitment letter, but the commitment letter is not usually filed until the buyer's next scheduled quarterly or annual report.

ENFORCEMENT OF CLAIMS AND INSOLVENCY

Restrictions on lenders' enforcement

30 What restrictions are there on the ability of lenders to enforce against collateral?

Prior to a bankruptcy filing the only limitations on enforcement are set forth in either the security documentation or the statutory restrictions included in the authorising statutes (such as the UCC requirement that all enforcement actions be conducted in a commercially

reasonable manner). Following a bankruptcy filing, most enforcement and other creditor actions are automatically stayed and prohibited without the leave of the bankruptcy court.

Debtor-in-possession financing

31 Does your jurisdiction allow for debtor-in-possession (DIP) financing?

Yes. The US Bankruptcy Code provides that a debtor in bankruptcy may enter into DIP financing, which must be approved by the Bankruptcy Court. Such financing is often entered into with existing lenders and, with their consent, benefits from superpriority liens on the existing collateral ahead of the existing debt.

Stays and adequate protection against creditors

32 During an insolvency proceeding is there a general stay enforceable against creditors? Is there a concept of adequate protection for existing lien holders who become subject to superior claims?

There is an automatic stay imposed in connection with all debtors in bankruptcy, which is enforceable against almost all creditors. In the event that a debtor seeks to diminish the value of any collateral held by a pre-petition creditor, it must provide adequate protection to such creditor. This is customarily given in the form of replacement liens, expense reimbursements, post-petition interest payments and non-economic benefits.

Clawbacks

33 In the course of an insolvency, describe preference periods or other reasons for which a court or other authority could claw back previous payments to lenders. What are the rules for such clawbacks and what period is covered?

Under the US Bankruptcy Code, transfers of interests in a debtor's property for the benefit of a creditor (which may include payments but also granting or perfection of liens) occurring within the 90 days (one year in the case of creditors deemed to be insiders) preceding the filing of a bankruptcy petition may be avoided as preferences (and clawed back) if:

- such transfer is made on account of a debt that existed before the time of the transfer (an antecedent debt – newly incurred debt is by definition not preferential);
- the debtor was insolvent at the time of the transfer; and
- such transfer would allow the creditor to receive more than it would have in a liquidation under Chapter 7 of the Bankruptcy Code if the transfer had not been made (in practice, this means that most payments to secured creditors would not be avoidable).

Ranking of creditors and voting on reorganisation

34 In an insolvency, are creditors ranked? What votes are required to approve a plan of reorganisation?

In a bankruptcy, each group of similarly situated creditors (and equity holders) is included in a class of claims. In general, the order of priority is for secured claims to be paid first

out of the relevant collateral. After secured claims are satisfied, administrative claims (such as the expenses of the bankruptcy proceeding and the costs of continuing to run the business during the bankruptcy proceeding and DIP financing) are paid. Following administrative claims, unsecured claims are addressed, with certain priority claims (such as taxes and pre-petition wages) being paid before general unsecured creditors (such as unsecured lenders, trade creditors, judgments and other amounts owed). Remaining amounts, if any, flow to the equity. All claims are subject to any agreements among creditors (or equity holders) or legal provisions allocating recoveries among the parties.

A plan of reorganisation may be approved with the vote of either each class of creditors or, so long as at least one 'impaired' class of creditors (that is, a class that is not receiving full payment on its claims or is otherwise accepting changes to its rights against the bankrupt entity) has approved the plan, through a cram down, where a plan is confirmed by the Bankruptcy Court over the objections of one or more dissenting classes. For a class to support the plan, over two-thirds of the class (by monetary amount) and over half of the class (by number of claims) must vote in favour of the plan.

Intercreditor agreements on liens

35 Will courts recognise contractual agreements between creditors providing for lien subordination or otherwise addressing lien priorities?

The Bankruptcy Code allows for intercreditor agreements and subordination agreements, and these are commonly enforced in and out of bankruptcy. Certain provisions of such agreements, however, have been successfully challenged by junior creditors in Bankruptcy Court, especially where such provisions are deemed to be overreaching.

Discounted securities in insolvencies

36 How is the claim of an original issue discount (OID) or discount debt instrument treated in an insolvency proceeding in your jurisdiction?

Generally, OID is allocated across the life of the relevant instrument. Any portion attributable to a period subsequent to the filing of bankruptcy is deemed to be unmatured interest, which is not collectable under the Bankruptcy Code.

Liability of secured creditors after enforcement

37 Discuss potential liabilities for a secured creditor that enforces against collateral.

Enforcement by a creditor against collateral that is personal property would be subject to the Uniform Commercial Code (UCC) as adopted in the state where the obligor or property is located. Even if the relevant security agreement provides a creditor wide latitude when taking enforcement action, the UCC at minimum imposes a duty of commercial reasonableness on every aspect of collateral disposition, including conducting a public or private sale, accepting collateral in partial or complete satisfaction of the secured obligation, involving the judicial system and collecting on account of or redeeming collateral.

In addition, a creditor that is seeking to enforce against collateral should review any relevant security agreements and intercreditor agreements, to confirm that it has not contractually agreed to limitations or requirements regarding the collateral, especially if the debt held by the creditor is junior debt.

UPDATE AND TRENDS

Proposals and developments

38 Are there any proposals for new legislation or regulation, or to revise existing legislation or regulation? If so, please give a reference to any written material, whether official or press reports. Are there any other current developments or trends that should be noted?

As of December 2022, loans based on Term SOFR have become the norm. It has become common for minor amendments for legacy deals to include provisions changing from LIBOR to Term SOFR.

On 13 July 2022, the Uniform Law Commission approved the final draft of its joint proposal with the Emerging Technology Committee of the American Law Institute for amendments to the Uniform Commercial Code regarding digital assets. After adoption of the final proposal, which itself will take some more time, it will be up to each state to individually enact legislation adopting the final proposal (and any state-specific variations).

In 2022, especially the second half of 2022, the portion of acquisition financings supported by direct lenders increased significantly in both deal number and dollar amount, as the high-yield debt markets faced challenges. Direct lenders also teamed up with traditional syndicated lenders to provide acquisition financing. While it remains to be seen whether these trends will continue, direct lenders likely will continue to be a significant source of debt capital for acquisition financings for the foreseeable future.

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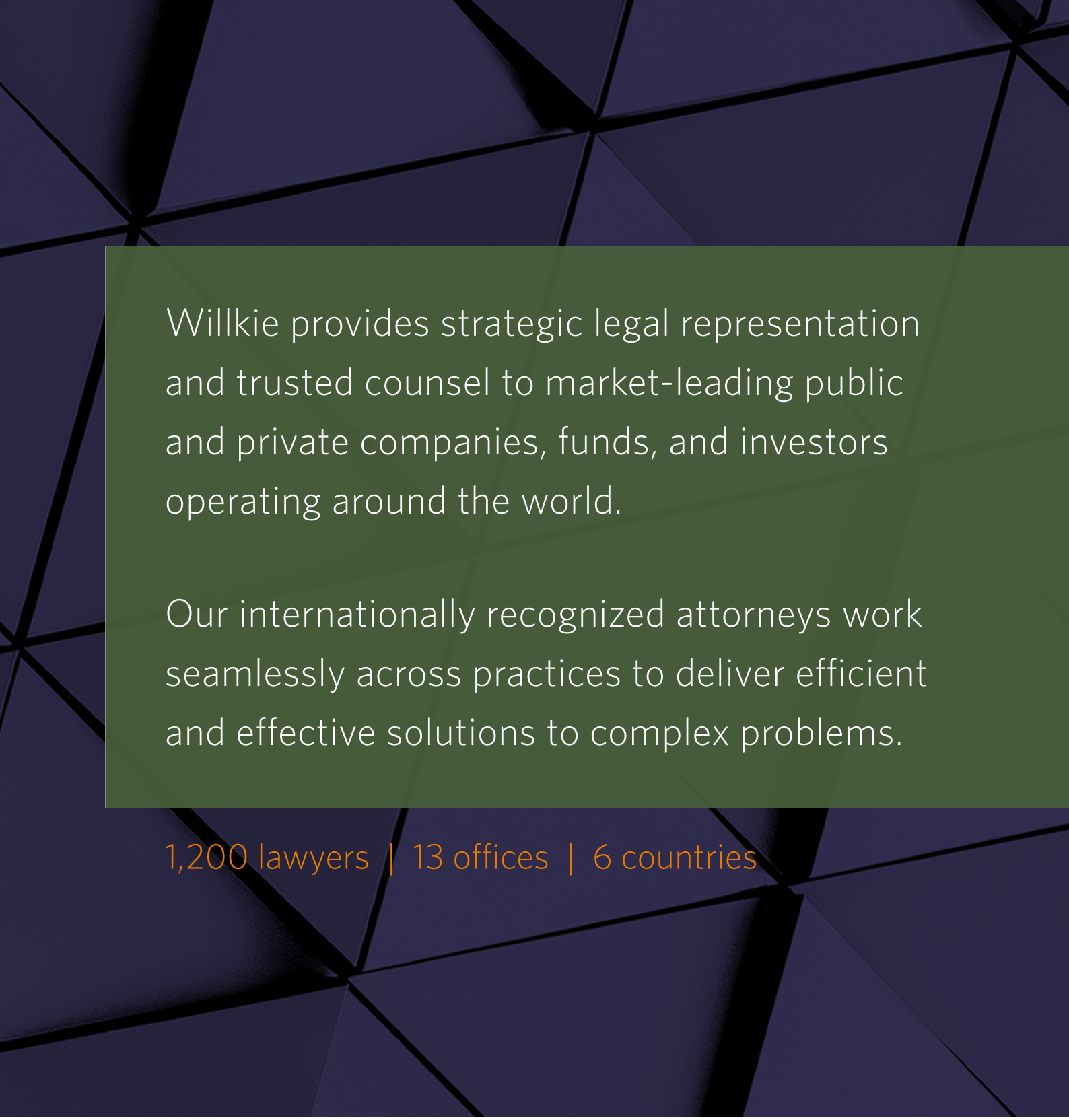

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Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public M&A
Public Procurement
Public-Private Partnerships
Rail Transport
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
Sovereign Immunity
Sports Law
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Technology M&A
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements