IBA Guide on Shareholders' Agreements

Luxembourg

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1. Are shareholders' agreements frequent in Luxembourg?

Shareholders agreements are common practice in Luxembourg, notably in major (e.g. private equity or joint-venture) transactions where the regulation of the parties' respective rights and duties with respect to their interests in a company is key.

2. What formalities must shareholders' agreements comply with in Luxembourg?

There are no specific statutory formalities for shareholders' agreements. The validity and enforceability of shareholders' agreements is governed by mandatory and public policy rules as well as general rules of contract law, notably the principle of contractual freedom and the principle of good faith. As such, a shareholders' agreement may validly exist through a simple exchange of consent between the parties. There are no requirements as to the form of the agreement.

If one or more of the parties to the shareholders agreement are individual persons, the agreement must, in order to be valid, and except as otherwise set out of the Luxembourg Civil Code, be executed in as many original copies as there are parties having opposite interests.

3. Can shareholders' agreements be brought to bear against third parties such as purchasers of shares or successors?

Unless the third party was aware of the existence of the shareholders' agreement (or could not have ignored its existence), shareholders' agreements only bind the parties and cannot create rights or impose obligations on third parties. Third party enforceability (including enforceability against the company itself) of key provisions such as transfer restrictions, can however be achieved by insertion in the articles of incorporation of the Company, which will be publicly available.

4. Can a shareholders' agreement regulate non-company contents?

There is no statutory prohibition which would prevent shareholders' agreements from regulating non-company matters, in addition to customary corporate issues.

Management rights and duties as well as commercial matters, are, amongst others, often set out in a shareholders' agreement.

5. Are there limits on the term of shareholders' agreements under the law of Luxembourg?

Shareholders' agreements may be concluded for a definite or indefinite period of time. Agreements without a fixed term may however, as a matter of statute, be terminated at any time by either party with reasonable notice, whereas agreements with a fixed term may only be terminated at the term. It is therefore usually advisable to provide for a fixed term (which can be many years). Similarly, if undertakings to vote in any particular way are included in the agreement (e.g. in the context of the appointment of nominee directors), such provisions should be subject to a specific (often shorter) term.

6. Are shareholders' agreements related to actions by directors valid in Luxembourg?

The board of directors is vested with the broadest powers to manage the business of a company, subject to such powers as may be reserved by law or by contract to the shareholders. It is common for shareholders' agreements to provide for specific veto rights for certain matters carried out by the board of directors, whether at the board level or by expressly reserving such matters to the approval of a certain percentage of shareholders.

The board of directors is often composed of individual members nominated by a specific shareholder. In that context it is important to note that directors in a Luxembourg company do not only represent the specific shareholder which nominated them for office, but owe a fiduciary duty towards all shareholders. A clause pursuant to which, for example, a director would be allowed to pass on confidential information relating to the company to his shareholder and not others would thus, in principle, not be valid on the basis of equal treatment of shareholders.

7. Does the law of Luxembourg permit restrictions on transfer of shares?

Shares in public limited companies are, by statute, freely transferable. Nothing prohibits contractual lock-ups provided they are reasonably limited in time and in the corporate interest of the company.

Shares in private limited companies may, according to statute, only be transferred to non-shareholders subject to the prior consent of the shareholders representing a majority of three quarters of the share capital. Stricter consent thresholds may be contractually agreed.

It is important to note that as a result of the principle that shareholders' agreements only bind the parties, a transfer of shares to a third party made in breach of a transfer restriction provision of the agreement may not be declared void against a third party purchaser acting in good faith. However, a share transfer made in breach of a transfer restriction set out in the bylaws will render the transfer unenforceable against the company, and the beneficiary of the transfer restriction may seek a voiding of the transfer.

Common transfer restrictions are set out below.

8. What mechanisms does the law of Luxembourg permit for regulating share transfers?

The most usual mechanisms (whose features and sophistication may vary) are:

a. **Approval clause**: the decision to sell the shares is subject to prior approval of, for example, the board of directors of the company.
b. **Preemption clause**: obliges the shareholder wishing to sell his shares to offer them in preference to the beneficiary of the preemption right. If the beneficiary of

the preemption right does not exercise its right the shares will normally be freely transferable by the seller.

c. **Lock-up clause**: allows the prohibition of the sale of shares during a certain period of time.
d. **Tag along rights**: allow a minority shareholder to be included in a transaction where the majority shareholder is selling its interests to a third party.
e. **Drag along rights**: allow a majority shareholder to require that a minority shareholder participate in a sale to a third party, the rationale being that a majority shareholder may not be able to realise the full value of its shares unless it can sell the entire company to a third party by dragging along minority shareholders. Drag along rights generally provide that the minority shareholder receive the same terms as the majority shareholder.

9. In Luxembourg do bylaws tend to be tailor-drafted, or do they tend to use standard formats?

The bylaws of Luxembourg companies are frequently standard and merely set out applicable legal provisions. The complexity of transactions, however, often requires tailor-made bylaws reflecting the key provisions of the agreement between the shareholders in relation to their rights and obligations in and the conduct of the business of a company, including, for the reasons set out above, transfer restrictions.

10. What are the motives in Luxembourg for executing shareholders' agreements?

Shareholders may choose to set out their rights and duties with respect to their interests in a company either in the bylaws or in a shareholders' agreement.

The advantage of shareholders' agreements is the simplicity in their application and flexibility in their amendment. Indeed, as mentioned before, they are governed by the principle of contractual freedom and may thus be freely amended by simple consent between the parties, whereas amendments of the bylaws of a company are subject to strict statutory rules. Flexibility is often key if the shareholders anticipate that the company's business requires regular changes to their arrangements, and where it may be unwieldy to repeatedly amend the bylaws.

Another key benefit of shareholders' agreements is confidentiality – contrary to the bylaws, a shareholders' agreement is not subject to any publication.

A specific group of shareholders may decide to execute a shareholders' agreement providing them with solutions adapted to their needs, without having to disclose their agreement to the other shareholders.

Other motives may include providing additional protection to minority shareholders; setting out agreements between several shareholders who control the company; providing for a bespoke distribution policy; or regulating the functioning of a joint venture.

11. What contents tend to be included in shareholders' agreements in Luxembourg?

Shareholders' agreements are often intended to supplement the bylaws or the general corporate law, by documenting an area that is not addressed by statute, or considering certain consequences related to the implementation of statutory rules. A standard Luxembourg shareholders' agreement will, subject to certain statutory restrictions, generally provide for the following:

- funding requirements and obligations to fund;
- voting arrangements;
- composition and functions of the board of directors;
- share transfer restrictions and obligations (see 8 above);
- reporting requirements;
- managers' undertakings;
- distribution policies;
- deadlock procedures;
- non-competition and non-solicitation clauses ;
- exit strategy.

As already mentioned, key provisions of shareholders' agreements may also be contained in the bylaws with a view to seeking enforceability against third parties. Certain provisions may, however, be omitted from the bylaws and solely set out in a shareholders' agreement for reasons of legal or commercial confidentiality.

12. What determines the content included in shareholders' agreements in Luxembourg?

The content of shareholders' agreements largely depends on the various commercial interests at stake for the parties, the complexity of the underlying transaction, the importance of having a legally binding instrument between shareholders and the need for confidentiality.

13. What are the most common types of clauses in shareholders' agreements in Luxembourg?

Typical clauses of a Luxembourg shareholders' agreement are:

- Clauses setting out the funding requirements and obligations to fund;
- Clauses containing voting arrangements;
- Clauses setting out the composition and functions of the board of directors;
- Share transfer restrictions and obligations (see 8 above);
- Distribution policies;
- Mechanisms dealing with deadlocks and defaults;
- Details on the proposed exit strategy.

14. What mechanisms does the law of Luxembourg permit to ensure participation of minorities on the board of directors and its control?

Luxembourg law permits the creation of various classes of shares and managers. The shareholders' agreement will typically provide for a mechanism whereby each holder of a class of shares is entitled to nominate his candidate(s) for appointment to the board of directors. Certain matters may be subject to the consent of the managers appointed by the minority.

15. **Is it possible in Luxembourg to ensure minority shareholder control by means of a shareholders' agreement?**

    Minority shareholder control may be achieved through contractual provisions such as quorum requirements, super-majority voting requirements for "reserved matters," provisions dealing with deadlocks in directors' or shareholders' votes, tag along rights, or rights to appoint board members (as set out in 14 above), and information rights.

16. **What are the usual valuation mechanisms in connection with rights of first refusal or share transfer regulations?**

    Although shares in a Luxembourg company have a nominal or par value, the transfer price will usually not correspond to this value. In the absence of benchmarks or comparable shares against which the market value of the shares can be evaluated, the determination of the price usually results from the use of an existing fair price evaluation model taking into account (i) the net asset value of the company; or (ii) the turnover value; or (iii) both values cumulatively. Parties will either agree in advance on a fixed price or rely on a third party's final determination. In order to be enforceable the valuation methodology needs to be as clear as possible.

17. **Is it admissible for a shareholders' agreement clause to refer dispute resolution to the courts other than those of Luxembourg and/or under a law other than that of Luxembourg?**

    On the basis of Regulation (EC) No 593/2008 of the European Parliament and the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), parties may freely choose the law governing their agreement, provided that this choice does not preclude the application of a provision of public policy and the parties do not act fraudulently. Notwithstanding the choice of law, in relation to proprietary law aspects of security interests and assignments, Luxembourg courts will apply the law of the place of the location of the charged assets (lex rei sitae) and for charged or assigned claims, the law of the place of the debtor.

    The submission to foreign courts of the European Union is valid and enforceable under Luxembourg law subject to European Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. Notwithstanding a foreign jurisdiction clause, Luxembourg courts would have in principle jurisdiction for any summary proceedings in connection with assets located in Luxembourg and such action would most likely be governed by Luxembourg law.

18. **Is it admissible for a shareholders' agreement to include an arbitration clause with seat outside Luxembourg and/or under a law**

    Although disputes relating to a shareholders' agreement governed by Luxembourg law are usually entrusted to the jurisdiction of the competent courts of Luxembourg, the choice of arbitration (ICC or domestic) is a possible alternative. The enforceability of a foreign arbitration clause before a Luxembourg court will be examined in accordance with the United Nations convention on the recognition and enforcement of foreign arbitral awards of 10 June 1958.