Professional payment guarantees: an innovative legal tool for financial transactions

The law of 10 July 2020 regarding professional payment guarantees (the“***PPG Law***”)[1] introduces a new and flexible type of personal security (*sûreté personnelle*) in the Luxembourg legal environment, which is expected to become a not-to-be-missed tool in the coming years.

Professional payment guarantees will certainly rival some foreign instruments, such as English law guarantees and the German law *Bürgschaft auf erstes Anfordern* and contribute to reinforcing the competitiveness of the Luxembourg legal market in Europe.

1. Rationale behind the adoption of the PPG Law

While the legislator allowed for considerable contractual freedom to define the terms of professional payment guarantees, it also ensured that this new legal regime affords sufficient legal certainty and predictability, so that any beneficiary of such guaranties can be reassured as to their efficacy.

The terms of the professional payment guarantees can thus include elements which were traditionally found in two types of personal guarantees under Luxembourg law, namely guarantees (*cautionnements*) and first demand guarantees (*garanties à première demande)*,without running the risk of the professional personal guaranteebeing re-characterised.

The aim pursued by the PPG Law is to reinforce Luxembourg's attractiveness as a key jurisdiction for international financial transactions. Some provisions of the PPG Law are somehow reminiscent of another fundamental piece of legislation, the law of 5 August 2005 on financial collateral arrangements, as amended (the "**2005 Law**"), of which the PPG mirrors some of the essential provisions. Among the most salient points in the PPG Law is the fact that a professional payment guarantee remains valid despite the existence of domestic or foreign insolvency proceedings or reorganisation proceedings affecting the guaranteed debtor.

2. Scope of the PPG Law

The PPG Law defines a professional payment guarantee as a commitment whereby a guarantor undertakes to pay a specific sum to a beneficiary according to the terms agreed between the parties in relation to one or more claims or risks related to such claims, upon request of the beneficiary or an agreed third party.[2]

a. Material scope

The PPG Law allows for most of the parameters of professional payment guarantees be tailored by the parties to meet their specific needs for a transaction, as long as they do not contravene Luxembourg mandatory rules or public policy.

In particular, the legislator has not imposed any restrictions as to the type of claims or risks that can be guaranteed. Accordingly, this new type of guarantee can cover a vast array of claims, such as obligations to pay or deliver financial instruments or assets, and more generally, any present, future, or even contingent or hypothetical claims, as well as individual claims or a portfolio of claims.[3] Therefore professional payment guarantees can be used in the context of various transactions, such as securitisation transactions or the granting of credit by public institutions to support undertakings.

b. Personal scope

The PPG Law allows all natural and legal persons to grant professional payment guarantees.

In addition, the legislator indicated that guarantees could also be granted by public entities, as well as entities without legal personality, such as special limited partnerships (*sociétés en commandite spéciales* or SCSp), regulated investment funds or securitisation undertakings that have been set up as mutual funds.

Finally, the PGG Law does not impose any restrictions on the identity of the beneficiary. As already prescribed by the 2005 Law, professional payment guarantees may be constituted in favour of a fiduciary or trustee acting on behalf of identified (or at least identifiable) third parties.

3. Legal regime

a. Formal requirement

The PPG Law requires that the parties expressly elect its application in the terms of the professional payment guarantee in order to avail themselves of this new favourable regime.

In addition, as is already the case for financial collateral arrangements under the 2005 Law, professional payment guarantees must be evidenced in writing, whether in electronic form or any other durable medium.

Parties are also free to convert an existing guarantee or first demand guarantee into a professional payment guarantee by amending the original document and expressly electing the application of the PPG Law.

b. A new set of beneficiary-friendly rules

The PPG Law provides that the object and terms of the professional payment guarantee may be freely determined.

The PPG Law incorporates a number of characteristics which are already familiar when dealing with financial collateral arrangements governed by the 2005 Law, which have been adapted to the specificities and functioning of personal guarantees. Such specific rules aim at reinforcing the protection afforded to beneficiaries and ensuring the efficacy of this new type of personal guarantee, although the guarantor and the beneficiary may contractually deviate from these rules.

It follows that the PPG law expressly authorises the option to disconnect the enforcement of professional payment guarantees from the existence of a default under the guaranteed claims or the materialisation of the guaranteed risks.

Furthermore, under the new guarantee regime, the guarantor shall, unless otherwise agreed, remain liable to the beneficiary for all of its obligations under the professional payment guarantee despite the existence of (i) domestic or foreign reorganisation or winding-up proceedings against the guaranteed debtor under the guaranteed obligations, and (ii) any situation where creditors have concurrent rights over the assets of such guaranteed debtor, or where the debtor's debts are rescheduled, reduced or converted into capital or other instruments. The legislator has however decided that the protective provisions of the law of 8 January 2013 on over-indebtedness, which concern non-professional debts of private individuals, would not be disapplied in relation to the guaranteed debtor.[4]

The PPG Law further provides that unless otherwise agreed, the guarantor will not be able to raise any defence arising from the guaranteed claims or risks, such as statutory limitation or the ity or unenforceability of the guaranteed claims.[5]

Once the professional payment guarantee is enforced, the guarantor is, unless otherwise agreed, entitled to exercise personal recourse against the person who requested that the professional guarantee be given to the beneficiary and is subrogated in the rights of the beneficiary in respect of the guaranteed claims up to the amount paid under the guarantee.

Conclusion

It is expected that professional payment guarantees will play a leading role in Luxembourg financial transactions and will increase creditor protection in a similar fashion as financial collateral arrangements have done since the Law 2005 entered into force. One would also hope that an indirect effect of the PPG Law will be to facilitate the granting of credit to private undertakings, which would be beneficial to the recovery of national economies from the COVID-19 crisis.

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[1] The PPG Law was published in the *Mémorial A* No. 582 of 13 July 2020 and entered into force on 17 July 2020.

[2] Article 2 of the PPG Law.

[3] Parliamentary document No. 7567/00, p. 4.

[4] Article 4 (6) of the PPG Law.

[5] Article 4 (4) of the PPG Law.

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