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Reform of the Luxembourg Company Law - Issue #3 – *Sociétés à responsabilité limitée*

This newsletter supplements the previous ones on the Luxembourg act reforming company law dated 10 August 2016, as published in the Luxembourg Official Gazette on 19 August 2016 and which came into force on 23 August 2016 (the "**Law**"), with respect to the main changes impacting the regime of Luxembourg private limited liability companies (*sociétiés à responsabilité limitée* – S.à r.l.), that can be outlined as follows:

1. Increase of the maximum number of shareholders
2. Decrease of the minimum share capital
3. Issuance of redeemable shares
4. Express recognition of tracking shares
5. Formal recognition of the board of managers (*collège des gérants*) and modalities of its functioning
6. Public issuance of bonds
7. Issuance of beneficiary shares
8. Voting agreements (*pactes d'actionnaires*)
9. Interim dividends
10. Special majority, change of the nationality of the company - no more unanimous consent, and authorised share capital
11. Approval of transfer of shares
12. Extension of the conflict of interest regime
13. *Conventions de portage*
14. Shares burdened with usufruct
15. *Apport en industrie*
16. Company conversions
17. New simplified liquidation procedure

1. Increase of the maximum number of shareholders (revised Art. 181(1))

The number of shareholders is no longer limited to 40 but has increased up to a maximum number of 100. If the number of the shareholders of the company exceeds 100, the company has one year to convert into another legal form.

2. Decrease of the minimum share capital (revised Art. 182(1))

The minimum share capital of the company has been decreased from EUR 12,394.68 to EUR 12,000.

3. Issuance of redeemable shares (revised Art. 182(2) to (7) and Art. 168)

It was an accepted practice that shares in an S.à r.l. could be redeemed on the terms and conditions set out in the articles of associa-

tion. The Law now expressly provides that the share capital may be represented by redeemable shares. The redemption must be authorised by the articles of association before subscription of the redeemable shares, and the articles of association must also set out the conditions for the redemption.

The Law regulates in particular the following aspects of share redemptions.

The redemption price must not be set at an amount that would affect the amount of the share capital and the legal reserve. Also, the aggregated amount of the nominal value or the accounting par value of the shares held by the shareholders (other than the redeemed shares) cannot be lower as an effect of the redemption, than the minimum share capital required by law.

Voting and financial rights attached to redeemed shares are suspended while those shares are held by the company.

In addition, the articles of association may authorise the managers of the company to cancel one or several redeemed shares by decreasing the share capital. In this event, the capital decrease will have to be subsequently acknowledged in a notarial deed to be passed within one month from the cancellation of the redeemed shares.

4. Express recognition of tracking shares (revised Art. 1853 Civil Code)

These new provisions, applicable also to, amongst others, the S.A., specify that, if a company has different classes of shares, the financial rights attached to any of those classes may be linked to the performance of different assets or activities of the company. The use of those shares, usually referred to as "tracking shares", was already an accepted practice.

5. Formal recognition of the board of managers (*collège de gérance*) and modalities of its functioning (revised Art. 191bis)

The Law expressly recognises that the articles of association may provide that a private limited liability company can be managed by a board of managers (*collège de gérance*). The Law also regulates in particular the following aspects of the decision-making process.

Unless prohibited in the articles of association, the managers may participate in a board meeting via videoconference or by any other electronic means enabling the identification of the person and the participation of the manager to the decision-making process before the approval of the resolutions (for example, a telephone conference). Meetings held by such means are considered to have taken place at the registered office of the company.

The members of the board of managers of the company may adopt the decisions in the form of circular resolutions by unanimous consent (as already widely done in practice), if this possibility is included in the articles of association. Decisions made following this procedure are deemed to be made at the registered office of the company.

6. Public issuance of bonds (revised Art. 188 and revised Art. 11ter)

The Law has removed the prohibition for an S.à r.l. to make public issuance of bonds, and therefore, an S.à r.l. is now able to proceed to a public issuance of bonds. The Law also sets out the principle whereby all companies may issue bonds..

7. Issuance of beneficiary shares *(parts bénéficiaires)* (revised Art. 182(1))

Already known to practitioners and regulated by law with reference to a public limited liability company (*société anonyme* – S.A.), *parts bénéficiaires* can now also be issued by S.à r.l.s. They are equity securities non-representative of the share capital and the articles of association determine the financial rights and/or voting rights attached to them.

8. Voting agreements (Art. 195bis)

The legislator has recognised, not only for S.A.s but also for S.à r.l.s that the exercise of voting rights can be subject to agreements

between shareholders. However, such agreements are invalid if:

- They violate the companies act or are against the corporate interest of the company;
- A shareholder commits to vote in conformity with instructions issued by the company, by its subsidiary or by the management or other legal bodies of the company or its subsidiaries;
- A shareholder commits to the company, its subsidiaries or their management or other legal bodies to approve the proposals made by the management or other legal bodies of the company.

Any vote in the general meeting of the shareholders or expressed in writing pursuant to instructions complied with under the commitment referred to in the second bullet point above is invalid and the invalidity of such vote triggers also the invalidity of the shareholder resolution unless it had no impact on the results of the votes for the adoption of such resolution.

9. Interim dividends (Art. 198bis)

The Law provides that the articles of association may authorize the managers to distribute interim dividends (which was already recognised by the law for an S.A. and largely used by market practice in respect of an S.à r.l.).

Distributions of interim dividends are subject to the following conditions:

a) Interim financial statements show that there are sufficient funds to proceed to the distribution;
b) The amount to be distributed must be taken from the available profits and reserves;
c) The resolution of the managers distributing interim dividends cannot be taken more than 2 months later than the date of the interim financial statements;
d) The statutory auditor or the independent auditor of the S.à r.l., if any, verifies that all the above conditions are fulfilled.

10. Special majority, change of the nationality of the company - no more unanimous consent, and authorised share capital (revised Art. 199 and Art. 11*quater*)

The double requirement of special majority (in number of shareholders and 75% of share capital) has been amended and the Law only requires a majority of 75% of share capital for amendments to articles of association.

A unanimous vote of the shareholders is no longer required in the event of an amendment to the articles of association changing the nationality of the company (and the usual majority for amendments to the articles of association applies).

Nevertheless, a unanimous vote is still required in the case of an increase in the commitment of the shareholders.

Finally, the Law introduced the possibility for an S.à r.l. to grant in the articles of association the authorization to the management to issue shares, beneficiary shares and/or convertible bonds, convertible loan instruments and warrants (together the "**Convertible Instruments**") under the authorised share capital mechanism.

11. Approval of transfer of shares (revised Art. 189 and Art. 11*quater*)

The transfer of any of its shares by a shareholder to a non-shareholder must be approved by shareholders representing 75% of the shares of the company at the general shareholders meeting or, if applicable, by written consent. Pursuant to the Law, this threshold can be decreased in the articles of association to 50%.

In the absence of such approval, the Law now provides a series of exit possibilities. Within 3 months from the date of refusal of the transfer (which can be exceptionally extended to a maximum of 6 months by the president of the district court), the shareholders may decide to purchase the shares or arrange for them to be purchased, unless the transferring shareholder decides not to proceed with the contemplated transfer. Alterna-

tively, the S.à r.l. may decide, with the consent of the transferring shareholder, to redeem the shares to be transferred by way of a share capital reduction. The articles of association determine the terms and conditions of the purchase by the shareholders and the redemption by the company of the shares. If the parties disagree on the price, the price will be determined by the president of the district court.

If, at the deadline, no solution has been implemented, the shareholder can proceed with the initial transfer of shares.

These provisions apply equally to beneficiary shares having voting rights and Convertible Instruments.

12. Extension of the conflict of interest regime (revised Art. 191bis(6))

The members of the board of management of an S.à r.l. are subject to the same conflict of interest regime as the members of the directors of an S.A.

The Law provides that any manager having a conflicting interest with the corporate interest must abstain from participating in the decision-making process.

The Law has defined more precisely an interest "in conflict": in particular the conflicting interest has been limited to a direct or indirect patrimonial interest *(intérêt de nature patrimoniale)*.

If, as a result of a conflict of interest, the applicable quorum requirement is not reached in respect of a particular matter, the board of managers may defer the decision on that matter to the general shareholders' meeting.

In addition, the regime of conflict of interest applicable to the members of the board of managers has been extended to include the officers in charge of the daily management of the company. Any such officer bearing an interest opposed to the corporate interest must abstain from the decision-making process. If only one person is in charge of the daily management, they must abstain and the board of managers can approve the decision. Any conflicting person not abstaining from the decision-making process, may be liable to the S.à r.l. or third parties for violation of the Companies Act.

These amendments apply also to the S.A.

13. *Conventions de portage* (Art. 1855 Civil Code)

The Law recognises the validity of *conventions de portage*, i.e. agreements providing that the shareholders may set up arrangements for the transfer or the purchase of shares for a set price (for example under a put option agreement or reciprocal put and call option agreements), as long as they do not have the sole aim of jeopardising the profit sharing or participation in the losses of the company. These arrangements often ensure a loss-free exit, but their validity was long questioned in the past, as they could be potentially considered as a *clause léonine*. Such arrangements have now been expressly allowed by the Law.

These amendments apply also to the S.A.

14. Shares burdened with usufruct (revised Art. 1852bis Civil Code)

Among the amendments to the Civil Code introduced by the Law, a new provision governs the exercise of the rights attached to shares burdened with usufruct.

When a share is burdened with usufruct, and the usufruct has been notified to the company or accepted by it, voting rights belong to the bare-owner, except for the resolutions concerning profits allocation that pertain to the usufructuary. The usufructuary has the right to the profit that the company will potentially allocate.

In the event of redemption of shares by the company, the bare-owner has the right to the amount corresponding to the value of the bare-ownership, while the usufructuary has a right to the amount corresponding to the value of the usufruct.

Nevertheless, the articles of association of the company may dispose otherwise.

These amendments apply also to the S.A.

15. *Apport en industrie* (revised Art. 183(3))

The Company may issue shares not only against a cash capital contribution or a contribution in kind, but also against a "sweat contribution" (*apport en industrie*). Sweat contributions do not become part of the share capital; nonetheless they entitle the contributor to hold shares in the company and to participate in profit distribution as well as to share potential losses of the company. Given the personal nature that characterises this type of contribution, shares issued against sweat contributions are non-transferable. The articles of association determine the rights attached to such shares.

16. Company conversions (Section XVquarter)

A newly introduced section of the Law regulates the steps that govern the change of a company's legal form.

Before proceeding with the conversion of an S.à r.l., an accounting statement must outline the assets and liabilities of the company at a date not more than 6 months from the date of the general meeting of the shareholders held to decide on the conversion of the company. However, if the latest annual accounts refer to a financial year ended at a date not more than 6 months from the date of the general meeting of the shareholders, this additional accounting statement is not needed. In addition, any of those financial statements (*état comptable*) are not necessary if all shareholders and security holders having voting rights have unanimously waived them. If the net asset value of the company is lower than its share capital, the difference must be indicated in the financial statements (*état comptable*).

The general meeting of the shareholders must approve the conversion of the company and the articles of association of the company in its new form following the majority rules established for the amendment of the articles of association.

Notwithstanding, if the S.à r.l. is to be converted into a general partnership, a limited partnership, an economic interest grouping, a civil company or a co-operative company with unlimited liability, the Law requires the approval of all shareholders.

In addition, if the S.à r.l. has undergone a contribution in kind within the 2 years preceding the conversion of the company and such a contribution in kind was not subject to the valuation report of an independent expert, as further set out in the Law, an independent auditor must make a report on the financial statements (*état comptable*) used for the conversion, and it must in particular state if the net asset value is overvalued. It has also to mention in its report the difference between the net asset value and the share capital if the net asset value is lower than the share capital.

The conversion of the company is established in the form of a notarial deed under penalty of being declared null and void. The conversion becomes effective vis-à-vis third parties once the deed of conversion, including the articles of association, has been published in the *Recueil Electronique des Sociétés et Associations* (RESA).

17. New simplified liquidation procedure (revised Art. 1865bis Civil Code)

The Law recognises the case where all shares of the company are held by a sole shareholder and acknowledges that the sole shareholder can proceed at any time to the dissolution of the company. In the latter case, the company is dissolved *without liquidation* by transfer of all assets and liabilities by way of universal transfer to the sole shareholder. Within 30 days from the publication of the notarial deed recording the dissolution decision in the RESA, the creditors may request to the president of the district court *(tribunal d'arrondissement)* that the sole shareholder grant them collateral. The president of the tribunal of the district court may dismiss such request only if the creditors already have appropriate collateral or if such collateral is not necessary in the light of the assets and liabilities of the sole shareholder.

These amendments apply also to the S.A.

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MOLITOR's Corporate & M&A team will be pleased to assist Luxembourg limited liability companies and their in-house legal teams in assessing their compliance with the new rules.

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