

## PLEDGE ON SHARES OF A LUXEMBOURG COMPANY - GOVERNING LAW -

Legal area: Securities – Private international law

By: Daniel Boone

To: WILDGEN Lawyers

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### 1. QUESTION

**Is it possible to have a pledge over the shares issued by a Luxembourg company governed by a law other than Luxembourg law?**

### 2. RESPONSE

#### 2.1. Principle

Under Luxembourg private international law principles, it is not possible to have a pledge over the shares issued by a Luxembourg company fully governed by a law other than Luxembourg law.

It is however possible to have such pledge partly governed by a law other than Luxembourg law.

#### 2.2. Demonstration

##### 2.2.1. Sound distinction between rights *in personam* and rights *in rem* aspects of the pledge

A sound distinction must be drawn up between rights *in personam* and rights *in rem* aspects:

- Rights *in personam* aspects relate to the contractual relationships between the pledgor and the pledge;
- Rights *in rem* aspects relate to the legal issues which concern the pledged assets and in particular the possibility to pledge such assets, the conditions of enforcement of the pledge - especially vis-à-vis third parties (*opposabilité du gage vis-à-vis des tiers*) - and the procedures to comply with to ascertain dispossession (dispossession being one of the condition of a Luxembourg pledge). Also, conditions, regime and effects of the enforcement of the pledge (*réalisation du gage*) are part of the rights *in rem* aspects.

## **2.2.2. Governing law**

### **2.2.2.1. Law governing the rights *in personam***

Given that rights *in personam* only rule the contractual relationship between the two parties (pledgor and pledge) to the contract, those issues can perfectly be ruled out by a foreign law, on the basis of contractual freedom and freedom of the choice of law. Therefore, any law may be freely chosen by the two parties to govern the rights *in personam* aspects of the pledge agreement

### **2.2.2.2. Law governing the rights *in rem***

#### **2.2.2.2.1. *Lex rei sitae***

Rights *in rem* aspects are governed by the *lex rei sitae*, i.e. the law of the jurisdiction where the assets (the shares) are effectively located.

#### **2.2.2.2.2. Ratio legis of the application of the *lex rei sitae***

Although the *lex rei sitae* rule of conflicts of laws has been subject to some doctrinal dissent, in particular in the French private international law literature (G. Khairallah, H. Gaudemet-Tallon), it has actually never been repealed in practice.

The *ratione* is that, vis-à-vis third parties in particular, only the application of the law of the *situs* of the assets is consistent with their best expectations.

The application of the *Lex rei sitae* rule of conflicts of laws therefore requires that the *situs* of the shares be determined.

#### **2.2.2.2.3. Determination of the *Situs* of the shares**

In respect of registered shares of a LuxCo, it is deemed that the *situs* of the shares is the jurisdiction where the shares register is maintained, i.e. in principle in Luxembourg, at the registered seat or at the effective place of management of the company.

In respect of bearer shares, the *situs* is the place where the *titres* representing the shares are physically located.

### 3. CONCLUSION

#### 3.1. General conclusion on the governing law of the pledge

Based on the above, it is perfectly possible to have a non-Luxembourg law governing the pledge agreement, however only in respect to the rights *in personam* aspects.

Adversely, and although the pledge agreement may state the contrary (foreign law expressed as the overall governing law to the pledge), all rights *in rem* aspects will be necessarily governed by Luxembourg law in case the shares of the Luxembourg company are effectively located in Luxembourg (see Section 2.2.2.2.3 above).

Luxembourg law shall govern the rights *in rem* aspects of the pledge agreement in its capacity as the “objective” applicable law (*loi d'application objective*) (and not as a mandatory law (*loi de police*)).

#### 3.2. Practical conclusions

In practice, for the sake of clarity, comfort and legal anticipation of further legal claims on that matter, it is highly recommended that:

- the *electio juris* clause expressly provides that the rights *in personam* are governed by the law of the chosen foreign jurisdiction;
- the *electio juris* clause expressly provides that the rights *in rem* are governed by Luxembourg law and in particular by the law of 5 August 2005 on financial collaterals (hereafter the “**Law of 2005**”);
- the rights *in rem* elements should be listed in the *electio juris* clause (see Section 2.2.1 above);
- the pledge agreement must detail the Luxembourg law rights *in rem* conditions, regime and effects, i.e. reflecting the most important related provisions of the Law of 2005: (i) registration of the pledge in the shares register (dispossession requirement), (ii) acceptance by or notification to the pledged Luxco of the pledge, (iii) respective rights on dividends and voting rights, (iv) authorized conditions of enforcement (*modes de réalisation du gage*). Of course, such substantial provisions may be adapted by the parties according to the contractual freedom allowed by the Law of 2005.