Corporate purpose vs Corporate interest in Luxembourg Restructuring and Insolvency

The concepts of "corporate purpose" and "corporate interest" of a commercial company,[1] whilst fundamental for corporate governance, are not defined in Luxembourg law or jurisprudence. In this article, we explore these concepts with a focus on restructuring and insolvency situations.

Defining corporate objects, interest and purpose; distinct features and potential overlaps

Corporate purpose; the objects clause

The corporate purpose of a company refers to the company's *raison d'être*, the specific corporate objectives for which the shareholders came together to initially incorporate the entity. Corporate objectives of the company are set forth in the objects clause contained in the governing "articles of association"[2] adopted by founding shareholders on incorporation[3] (and amended from time to time in accordance with the procedures set out in the Companies Law and the Articles).[4]

A company's corporate objects clause draws the outer limits of the activity that the company can pursue. An objective outside the corporate objects could only be pursued if the company's Articles were to first be amended by shareholder decision.

Corporate interest

Identifying a company's corporate purpose is a straightforward process by reference to the restrictions contained in the relevant objects clause. However, the process of defining a company's corporate interest is significantly more complex, as pursuant to Luxembourg law it includes anything useful or profitable to the *company*.[5] Nonetheless, in determining the corporate interest, consideration is given only to the benefit of the company *itself* and not to that of relevant third parties.[6]

Often the company's corporate interest will be aligned with that of its shareholders or its subsidiaries, but there is no automatic overlap. Legal authors agree that corporate interest goes beyond and is separate from the interest of the shareholders (and the same logic is applied to the interest of creditors). In contrast to some other European jurisdictions, corporate interest in Luxembourg is not determined by the sum of individual interests of the shareholders or the intersection of their interests.[7] Appropriate attention needs to be paid to this point in Luxembourg law as it this may be surprising to those unfamiliar with Luxembourg law.[8] For example, a conflict of corporate interests between the company and shareholders and creditors may come into play when a company in distress receives an offer to restructure and survive as a going concern, where such offer from senior creditors may result in a change of control (detriment to existing shareholders) or a write down of junior debt pursuant to a restructuring process (detriment to junior creditors).

Considering that there will often be overlaps between the above concepts and the interests of the various stakeholders, it follows from the above that a company's corporate interest is a separate legal concept (x) from the same company's corporate purpose, and (y) from the interest of any third parties, including the company's direct shareholders and creditors. It would be improper to mix the analysis of one concept with the other and there is no basis for doing so under Luxembourg law.

Assessment of a company's corporate purpose and corporate interest

Relevant body and no group concept

As referenced above, the corporate purpose of a company is determined by shareholders pursuant to the objects clause contained in the Articles. The relevant body tasked with assessing corporate interest is the board. The board is a collegiate body and any decision duly taken is attributable to the board as a whole.[9]

In assessing corporate interest, it is also important to note that Luxembourg law does not follow a "*group of companies*" concept, and hence the analysis must be undertaken separately by the applicable board in the interests of the company alone and not that of the group's.[10]

A holding or financing company is usually part of a corporate structure that includes

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multiple companies. The same directors often sit on the boards of multiple group companies. However, these directors must change "corporate hats" for the purposes of examining whether the contemplated transaction falls within the relevant company's corporate objects clause and best serves the interests of that specific company.[11]

An action that is within the corporate purpose does not automatically qualify as in the company's corporate interest

The nature of the directors' assessment

The board's central duty is to act in furtherance of the company's corporate purpose and corporate interest. As a company's "corporate purpose" is a distinct concept from its "corporate interest", the board's assessment will also be separate.

Assessing a company's corporate purpose

The outer limits of directors' actions, i.e., the type of transactions they can undertake when representing the company (e.g., granting loans, pledges), are mandated by the company's corporate purpose. As a preliminary step, the board must ensure that the contemplated acts are permitted under the company's corporate objects as reflected in the company's Articles. If the board proceeds with an action outside the corporate objects, this will amount to a breach of the Articles.[12]

Assessing a company's corporate interest

An action that is within the corporate purpose does not automatically qualify as in the company's corporate interest.[13] The assessment of whether a transaction is in the company's corporate interest is not a legal or procedural assessment, but a factual and substantive assessment. The board of the relevant company must consider the circumstances of each transaction, make an economic and financial analysis of the contemplated transaction, and compare alternatives available to the company at the time of the assessment. If several options are available, the directors must compare and weigh the benefits of all options against one another and choose the one that best serves the interests of the company.[14] Factors to be taken into account during this quantitative and qualitative determination are the maximization of financial benefits, costs, the requisite means and timing for the implementation, and any external risks.

Assessing a company's corporate interest in insolvency situations

Both the SA and the SARL are commercial companies and are formed to undertake commercial activities, i.e., activities with the aim of making a commercial profit.[15] Where a company considers that it may be insolvent or is aware that it may require a restructuring of its debt to prevent bankruptcy or insolvency, trust towards the company is undermined and the company becomes less attractive to third parties, including investors or potential financiers. At the same time, the company may not have the necessary resources to stay operational during a restructuring or insolvency proceeding and may suffer further cost-leakage due to the expenses and long waiting periods associated with any insolvency proceedings.

Given the above, it should be regarded in any distressed situation that the board must use its best efforts to prevent a bankruptcy by exploring viable alternatives before filing the company for bankruptcy. A board must prioritize the company's survival, in which case the "best offer rule" can be applied when assessing the company's corporate interest. The duty of the board to further the company's corporate interest in practice translates in opting for the most viable solution available to the company.

The board should apply the "best offer rule" by using the quantitative and qualitative process described above with projected timing for the implementation of the financial restructuring being crucial. The board must consider, in its determination, any restructuring proposals that are capable of implementation and in good faith will lead to the survival of the company as a going concern.

In summary, the board shall act in furtherance of the company's corporate purpose and corporate interest by opting for the restructuring proposal that is in the best interests of the company if such restructuring proposal, in good faith, can prevent a bankruptcy.

Standards and principles that guide the board in its assessment of a company's corporate purpose and corporate interest

Directors have a duty to act in the company's best interests and in doing so they must adhere to certain standards and principles briefly summarized below. These standards and principles aim at safeguarding the corporate interest of a company.

(i) **No violation of the Companies Law and the Articles.** The directors have a duty to act in accordance with the provisions of the

Companies Law and the Articles. Acting against this would typically amount to a breach of these texts.[16]

(ii) **The reasonable person standard.** Any decision undertaken by the board must pass the reasonableness test. A board must exercise its duties with as much care, diligence and skills as would be displayed by a reasonable person in the same circumstances.
A decision in line with the reasonable person standard is not automatically in the best interest of the company because the positive determination that a transaction favours the company's corporate interest requires a higher standard of diligence by the board. It follows that a decision taken in furtherance of the company's corporate interest will always meet the reasonable person standard test, but it is not necessarily the case that the corporate interest test is met when the reasonable standard test is met. The two concepts are intertwined but not identical.

(iii) **Loyalty, honesty and in good faith.** In addition to acting reasonably, the directors must act with loyalty, honesty and in good faith for the company's exclusive benefit. Luxembourg law, unlike certain common law jurisdictions, does not recognize a concept of "fiduciary duty of directors".[17]

(iv) **No violation of equal treatment.** Upon decision-making, directors should not breach the equal treatment of shareholders.[18] Directors must make sure they do not allow any natural tendencies to promote the interests of the party that nominates them for appointment to the board to interfere with their judgment.

For completeness, we note that when a director breaches his/her management duties including acting against the company's purpose and interest, as well as the above duties, that director can face various forms of civil or criminal liability under Luxembourg law.[19] Directors may be civilly liable for breaching their management duties, the Companies Law, or the company's Articles or *in tort* for harm caused to third parties. Directors may also face criminal liability from misconduct in the management of the company's affairs (*faute de gestion*), when a director in bad faith uses his / her voting influence to the company's detriment and for the benefit of a third party.[20]

Judicial assessment as to the existence of corporate interest

When reviewing whether a transaction that has been undertaken by the board was in the best interest of the company, the extent of judicial review permitted is limited. In examining the position, a Luxembourg court will put itself in the position of the board at the point in time that the board decision was made and perform a fringe control (contrôle marginal) of the decision.[21] The rationale for this under Luxembourg law is similar to the rationale behind the US business judgment rule, i.e., it would be unfair to expect from the directors to make right decisions all of the time.[22]

Conclusion

To conclude, the company's own interests, which may divert from that of shareholders or creditors, take priority over any other interests and must stand-alone determine the outcome of any decision of the board, including negotiating and implementing any restructuring proposals in insolvency situations. The board can be liable under Luxembourg law for acting against the company's corporate interest if: (i) it undertakes any actions that are not beneficial to the company, or (ii) it remains passive when it should have acted to avoid a detriment, such as its bankruptcy. These considerations, applicable standards and principles must all be taken into account in the directors' decision-making process and become even more relevant in insolvency situations, where typically the pressure the board receives from shareholders, lenders, employees and other third parties to act in a specific fashion (and in the interest of that third party) will be substantial. ■

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Footnotes:

1 This article focuses on the Luxembourg "société anonyme" ("SA"), a public limited liability company, and the Luxembourg "société à responsabilité limitée" ("SARL"), a private limited liability company. For ease of reference, we hereby refer to both corporate forms as "companies," and to their directors (for public companies) or managers (for private companies) simply as "directors" or as the "board".

2 Hereafter "the Articles".

3 Articles 420-15 (S.A.) and 710-7 (SARL), Law of 10 August 1915 on commercial companies (hereafter "the Companies Law").

4 The process for amending the articles of association of a company (including its corporate objects) is included in Articles 450-3 (SA), 710-17 and 710-18 (SARL), Companies Law, and typically in the Articles.

5 Y. Payen and F. Brouxel, "Defensive strategies and other "Poison Pills" and "Shark Repellents" available to the management board of a (target) company under the Luxembourg Law of 19 May 2006 on takeover bids" *Droit Bancaire et Financier au Luxembourg*, Volume IV, 2014, 1956.

6 A. Steichen, *Précis de droit des sociétés* (6th edn) (Larcier/Intersentia, 2018), 453.

7 Idem.

8 F. Magnus, "Appréciation des contours de l'intérêt social: regard critique à travers les enseignements tirés des notions d'"intérêt de groupe" et d'"avantages anormaux ou bénévoles"", *Revue Pratique des Sociétés*, n° 7057, 2011/3, 327.

9 Steichen (above note 6), 290.

10 Ibid., 453.

11 Ibid., 282.

12 Types of liability that arises from such breach are briefly mentioned below in Part 2(B)(4).

13 Steichen (above note 76), 282.

14 X. Dieux and D. Wilermain, "L'acquisition de l'entreprise par les cadres, actualisation des contraintes applicables à ce type d'opérations, au regard du droit des sociétés commerciales", Actualités en droit des affaires (Vanham & Vanham, 2003), 212; J. M. van Hille and N. François, *La société anonyme, aspects juridiques et pratiques* (Bruylant, 1992), 73.

15 Art. 100-2, Companies Law.

16 Steichen (above note 6), 285.

17 Ibid., 286.

18 Payen and Brouxel (above note 5), 1967.

19 Liability of the directors is outside the scope of this article and is only briefly mentioned.

20 Decision of the Luxembourg District Court dated 13 May 2002, roll Nos 66466 and 66486; Steichen (above note 7), 285.

21 van Hille and François (above note 14), 73; G. Nyatanyi and G. Smets, "Corporate Interest under Belgian Law: A Practical Approach" *Forum Financier/Droit Bancaire Et Financier*, Volume III, 2008, 161.

22 Payen and Brouxel (above note 5), 2004.