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Client Alert
Commentary

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Alteco / Mag Import Case: New Developments for Secured Creditors

Luxembourg court decisions allow secured lenders to enforce Gecina share pledge.

A controversial insolvency dispute winding its way through courts in Spain and Luxembourg may reinforce the rights of secured lenders to enforce financial collateral within an insolvency proceeding. While the recent Luxembourg Tribunal decision enforcing a financial collateral pledge for payment default appears to favor the secured lenders, a potentially contradictory decision from the Spanish Commercial Courts throws the issue into uncertain territory.

Background

Alteco Gestión y Promoción de Marcas, S.L. (Alteco) and Mag Import, S.L. (Mag Import) are two Spanish holding companies which, as a result of an initial tender offer for Metrovacesa, S.A., own shares in the French listed company Gecina S.A. (Gecina) — the largest residential and commercial property owner in France. In order to finance the tender offer, Alteco and Mag Import entered into a Spanish law governed syndicated facility agreement (the Facility Agreement), subsequently secured by means of a pledge over their shares in Gecina (the Pledge), which in turn was subject to Luxembourg law (in particular, to the 2005 Act which transposed the European Directive 2002/47/EC on financial collateral arrangements (the Financial Collateral Directive)).

The Pledge provided that it would be enforceable upon early termination. Closer to its maturity and within the two-year look-back/claw-back period set out by the Spanish Insolvency Act 22/2003 of 9 July (the Spanish Insolvency Act), the Pledge was amended in order to be expressly enforceable upon default of payment on maturity (the Amendment).

Action Before Spanish Courts

Following payment default upon maturity, Alteco and Mag Import initiated insolvency proceedings and the secured creditors attempted to enforce the Pledge in accordance with the Financial Collateral Directive (as transposed into Luxemburg law).

Alteco's and Mag Import's insolvency receivers deemed that the Amendment was detrimental to the insolvent debtors' estate. In their view, the Amendment extended the obligations secured by the Pledge given the Amendment's now broader definition of an enforcement event. Therefore, the insolvency receivers decided to bring a claw-back action before the Spanish Commercial Courts (Juzgados de lo Mercantil). However, Alteco's and Mag Import's insolvency receivers did not have sufficient time to assemble the necessary documents and as the Pledge could be swiftly enforced, they requested an interim injunction to suspend enforcement of the Pledge. The Spanish Commercial Courts awarded the

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interim injunction, allowing the insolvency receivers to bring the claw-back action regarding the Amendment.

Action Before Luxembourg Tribunal

In view of the above impasse, the secured lenders brought an action before a Luxembourg Tribunal. They requested that the Tribunal declare, inter alia, that: (i) a payment default is, by its very nature, an enforcement event under a Luxembourg law pledge, and (ii) the Spanish interim injunction could not prevent the Pledge from being enforced. The secured lenders also requested the Luxembourg Tribunal to order the depositary bank to transfer to them the Gecina shares subject to the Pledge.

The Luxembourg Tribunal ruled that, due to the fact that the action brought before the Luxembourg Tribunal was independent from the Spanish insolvency proceedings, jurisdiction should be determined pursuant to article 23 of the Brussels I Regulation. Such article, in summary, sets forth that the courts with jurisdiction shall be those agreed by the parties, *i.e.* in this case, the Luxembourg Courts and Tribunals.

On the basis of Luxembourg law (which was deemed applicable as per the jurisdiction clause in the Pledge), the Luxembourg Tribunal ruled that a creditor's right to enforce a pledge on default of payment at the relevant facility's maturity is the essence of a pledge, and that any clause which deprives a creditor of such right must be considered null and void. Therefore, the secured lenders had the right to enforce the Pledge regardless of the outcome of the claw-back action brought by the Spanish insolvency receivers.

Accordingly, the Luxembourg Tribunal served notice to the depository bank to transfer the Gecina shares to the secured creditors and the Pledge was enforced by appropriation in accordance with the Financial Collateral Directive.

Legal Considerations

The Luxembourg Tribunal's ruling reinforced the stated purpose of the Financial Collateral Directive, namely to ensure that financial collateral arrangements are effectively enforced pursuant to their terms, even upon insolvency events. As previously noted, this principle has been transposed into Luxembourg and Spanish law.

In addition, as the Luxembourg Tribunal pointed out, article 5 of the European Insolvency Regulation (EC/1346/2000) (the Insolvency Regulation) sets forth that the opening of insolvency proceedings will not affect *in rem* rights pertaining to the insolvent debtor's assets which are located within the territory of a Member State different from that where insolvency proceedings are opened. This wording suggests that the Pledge should not be affected by the insolvency proceedings in Spain and that the Luxembourg Tribunal correctly assumed jurisdiction to resolve the issue.

However, the above should be read in conjunction with articles 4.2(m) and 13 of the Insolvency Regulation, which deal with the determination of which law governs acts detrimental to all creditors. According to the default position, the law of the State of the opening of insolvency proceedings determines the rules relating to the unenforceability of detrimental acts. An argument can be run, however, that a different Member State has jurisdiction (in this case Luxembourg), if the original law (Spanish here) does not allow any means of challenging the detrimental act.

Spanish Royal Decree Law 5/2005, of 11 March, on reforms for promotion of productivity and improvement of public procurement — which transposed the Financial Collateral Directive in Spain — sets forth that financial collateral arrangements formalized before the initiation of insolvency proceedings may only be rescinded or challenged pursuant to the terms of article 71 of the Spanish Insolvency Act by the insolvency receivers, on the basis that the relevant act has been carried out fraudulently vis-à-vis the creditors (that is to say, that there was an intention or knowledge of the detriment caused to other creditors by the relevant parties (*consilium fraudis*)).

In light of the above, and of the current wording of article 71 of the Spanish Insolvency Act, Spanish law does technically allow for the possibility of challenging the enforcement of the Pledge — provided the insolvency receivers can prove that: (i) the Pledge enforcement is detrimental to the insolvent debtor's estate, and (ii) enforcement has been carried out fraudulently vis-à-vis the creditor group.

Bearing in mind that Alteco and Mag Import are mere holding companies with no activity other than holding the shares in Gecina, we believe arguing that the secured lenders acted with intention to defraud the other creditors, or that they carried out an act which was detrimental to Alteco's and Mag Import's estate, would be very difficult. This is especially so as the holding companies executed the Amendment merely to reflect a market standard and to allow for parties to enforce in the event of non-payment upon maturity (that this Amendment turned out not to be necessary and the scrutiny by the Spanish Court could have been avoided is another matter altogether!).

Notably, in the event that the Spanish Courts were to rescind the enforcement pursuant to the above, the secured creditors' claims would become subordinated to secured and unsecured creditors alike. This last point would clearly be met with considerable resistance by the secured lenders.

And Now...What?

At this stage, we have a Spanish Court which awarded an interim injunction whereby the enforcement of the Pledge has been suspended. At the same time, a Luxembourg Tribunal has ruled that the very same Pledge is enforceable and further, that the Pledge has, in fact, been successfully enforced.

In this controversial situation, predicting what will happen next is difficult. Will the Spanish Commercial Courts rescind the enforcement of the Pledge? Will Alteco and Mag Import bring a claim against the secured lenders requesting damages? Could other insolvency receivers attempt to stop a financial collateral enforcement using an interim injunction? Is there a loophole in the Financial Collateral Directive?

We understand that the controlling shareholder of Alteco has in the meantime brought a criminal action before Spanish Courts against certain creditors who have enforced the Pledge.

Undoubtedly, the developments in this case will be of considerable interest to many cross-border lenders in the debt market. We will continue to keep a very watchful eye on and report on future developments.

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