LATHAM & WATKINS

Number 1009 5 April 2010

Client Alert

Latham & Watkins
Finance and Restructuring &
Insolvency Practice Groups

Coeur Défense Safeguard Proceedings: Landmark Paris Court of Appeal Decision on Creditors' Rights

"The Court of Appeal decisions provide useful guidelines in the context of restructurings of French financing transactions, which are also likely to be factored in when structuring new financing transactions."

Introduction

Since the Paris Commercial Court opened safeguard proceedings towards Heart of La Défense SAS (**Hold**) and Dame Luxembourg (**Dame**)[1] in November 2008, lenders have been wary of sponsors/borrowers in LBOs and structured finance transactions attempting to use the newly instituted French safeguard proceedings (*procédure de sauvegarde*) regime to gain leverage over their lenders in restructuring negotiations, by neutralizing (or threatening to neutralize) the enforcement of their security package.

The Paris Court of Appeal's decision of 25 February 2010[2], rescinding the opening of the safeguard proceedings of Hold and Dame, provided relief to lenders. The Court of Appeal explicitly held that safeguard proceedings should not be used (i) by a borrower merely to suspend the application of contractual provisions of its loan agreement that it was not able to modify consensually, or (ii) by a grantor of credit support merely to paralyze the creditors' contractual right to appropriate the collateral securing their claim (*pacte commissoire*). A similar ruling was made by the same Court on the same day in the so-called "Mansford" case[3], another real estate acquisition structured financing.

This decision is important for restructurings of French incorporated holding companies, and also for cases brought into France by reason of a "COMI shift". In the *Coeur Défense* decision, Dame had indeed its registered seat located in Luxembourg, but requested the opening of safeguard proceedings in France, arguing successfully that its COMI (center of main interests) was situated in France.[4]

The Court of Appeal also confirmed - in another decision rendered on the same day in the *Coeur Défense* safeguard proceedings - the judgment made on 19 October 2009 by the Paris Commercial Court, with respect to a French Dailly law security assignment of trade receivables (*cession Dailly*) (**Dailly security assignment**). Notwithstanding a temporary set-back in initial summary proceedings, the efficacy of the mechanism had been once again affirmed by the Paris Commercial Court in a ruling on the substance of the litigation, thus providing assurances to creditors (which included many international credit institutions), and more generally the finance community at large, that the validity and enforceability of a Dailly security assignment are not affected by the opening of safeguard proceedings (*see Client Alert 959*).

Background: Safeguard Proceedings

A company that is subject to the French safeguard proceedings regime is entitled to request that it be placed under safeguard proceedings if, although it is cash-solvent, it experiences "difficulties" that it is not able to overcome[5]. The aim of safeguard proceedings is to facilitate the reorganization of a company in order to allow (in that order) the continuation of its business, the protection of employment and the payment of its creditors. The term "difficulties" as used in this context is not defined in the French Commercial Code. The various Commercial Courts seized with the issue had interpreted this provision on a case-by-case basis, and there was growing concern in the finance community — in particular after the *Belvédère*[6], *Coeur Défense*, and *Financière Hélios*[7] cases — that their interpretation was taking a particularly creditor-adverse route.

The secured creditors in particular were all the more concerned by the opening of safeguard proceedings since, as from the date of the court order commencing the safeguard proceedings towards an entity:

- if that entity is a debtor, pursuing any judicial action against the debtor to obtain payment of any debt previously incurred is prohibited;
- if that entity is the grantor of security interests, enforcement of such security interests (including those which provide for a mechanism whereby creditors may appropriate the collateral without a court decision) is prohibited[8]; and
- absent the adoption of a safeguard plan by the relevant majority of creditors, the court can also impose on creditors a rescheduling of their claim (full face value and accrued interest) over a maximum time period of 10 years.

Coeur Défense Restructuring

In July 2007, at the height of the property boom, the *Coeur Défense* complex — a 39-story glass office tower in the center of the Paris *La Défense* financial district — was acquired for €2.11 billion by Hold, a special-purpose vehicle registered in Paris, which is owned by Dame, a Luxembourg holding company. The shareholders of Dame include now former Lehman Brothers Holdings Inc. entities.

To fund the acquisition, Hold entered into two loans in an aggregate principal amount of €1.64 billion granted by Frankfurt-based Lehman Brothers Bankhaus AG. Such loans were subsequently transferred by way of a securitization to the *Fonds Commun de Titrisation* Windermere XII FCT[9], managed and represented by Eurotitrisation, and which therefore became the sole creditor under these loans. To fund these purchases, the FCT issued 12 categories of commercial mortgaged-backed securities (CMBS), purchased by many first-ranking financial institutions.

The documentation provided that the loans would be repayable *in fine* in July 2012 or (in certain circumstances) in July 2013 or July 2014.

The loans were secured by various security interests, which included Dailly security assignments of all existing and future claims under existing or future leases of the property complex and a limited-recourse pledge by Dame over its shares in Hold.

Another Lehman Brothers entity, Lehman Brothers UK, provided hedging in the form of interest-rate caps, in favor of Hold with respect to the loans, which were at a floating interest rate.

The collapse of the Lehman Brothers entities on 15 September 2008 resulted in the downgrading of the Lehman entity providing the hedging, itself triggering an obligation upon Hold under its loan to substitute an alternative hedging arrangement with another counterparty. Having failed to provide such a replacement, Hold was notified of the existence of an event of default (although the loans were not accelerated) and decided to file for the opening of safeguard proceedings. The same filing was made by its holding company, Dame.

Hold and Dame obtained the opening of safeguard proceedings by the Paris Commercial Court on 3 November 2008, thereby causing a stay on judicial actions against them and a stay on enforcement proceedings over their assets. The Paris Commercial Court considered that both entities could justify "*difficulties that could lead to a suspension of payment and that [they] could not overcome without the respite offered by a safeguard plan*".

On 9 September 2009, a safeguard plan was decided by the Paris Commercial Court with respect to Hold and Dame. Under the plan, the Court in particular extended the 10 July 2012 maturity of the loans to 10 July 2014. However, in October 2009, the State prosecutor lodged an appeal against the adoption of Hold's safeguard plan. This triggered the suspension of the safeguard plan's application.

On 8 December 2008, the FCT had challenged before the Paris Commercial Court its decision to open safeguard proceedings with respect to Dame and Hold, arguing that safeguard proceedings were not warranted in the circumstances, since Hold and Dame were special-purpose vehicles with no economic activity. On 7 October 2009, the Paris Commercial Court nonetheless upheld the opening of safeguard proceedings. The FCT appealed this decision before the Paris Court of Appeal.

Coeur Défense Safeguard Proceedings Lifted by Paris Court of Appeal

On 25 February 2010, the Paris Court of Appeal rescinded the decision of the Paris Commercial Court opening the safeguard proceedings over Hold and Dame, thereby denying both entities the protection of such proceedings. The Paris Court of Appeal ruled that the criterion required for the opening of safeguard proceedings (difficulties which the debtor is not able to overcome – *see above*) was not met.

Control by Court of Difficulties and Grounds Invoked for Opening Safeguard Proceedings

The most interesting aspect of the *Coeur Défense* decision is that the Paris Court of Appeal both characterized the difficulties that should exist in order to justify the opening of safeguard proceedings as needing to be "operational" difficulties and controlled the motives of the debtors for requesting that they be opened.

The Court ruled that neither Hold nor Dame were facing difficulties in running their businesses (real estate renting activities in the case of Hold; management of securities portfolio in the case of Dame) that they could not overcome.

The Court specified that **Hold** was indeed facing unanticipated circumstances which rendered the performance of the hedging covenants more onerous, but that it was not facing difficulties to run its business, *i.e.* real estate renting activities. The Court ruled that, taking into account the basic legal rule that contracts should be binding on parties, Hold was not entitled, in the absence of actual difficulties in carrying out its business, to use safeguard proceedings for the sole purpose of attempting to impose on the lenders a modification of the loan agreement.

As regards **Dame**, the Court highlighted that, notwithstanding the alleged difficulties faced by its subsidiary Hold, Dame had only granted a pledge over its shares in Holdco to secure Hold's borrowings, and would be released from all its obligations upon enforcement of the pledge solely by the transfer of the pledged shares to the FCT, without being liable for any additional amounts under the loan agreement. In addition, Dame had no indebtedness other than a shareholders' loan, which was not repayable before maturity and which the Court thought unlikely to be accelerated.

On the same day, the Paris Court of Appeal granted a similar ruling with respect to the Luxembourg-incorporated

real estate group Mansford, stating similarly that, notwithstanding the breach of the "Loan to value" or "LTV" ratio tested at the level of the company, the real estate renting activities of the group were not impaired, and that safeguard proceedings should therefore not have been opened.

Appeal Against Paris Court of Appeal Decision

Hold and Dame have challenged the Paris Court of Appeal decision before the French Supreme Court (*Cour de Cassation*). One of the arguments that should be reviewed by the French Supreme Court is whether the Paris Court of Appeal was justified in specifying that a company must experience **operational** difficulties to request the opening of safeguard proceedings, since the French Commercial Code only refers to "***difficulties*** *that it is not able to overcome*".

Conclusion: Impact of *Coeur Défense* Paris Court of Appeal Decision on Ability for SPV to Initiate Safeguard Proceedings

The *Coeur Défense* and Mansford cases are quite fact-specific and the *Coeur Défense* decision has been challenged before the French Supreme Court.

The finance community therefore remains somewhat cautious in drawing definitive conclusions from this case-law.

These decisions nonetheless bring some clarity with regard to the way French courts are likely to treat requests to open safeguard proceedings based on non-operational difficulties and/or solely for the purpose of suspending the rights of creditors, including in particular secured creditors.

Indeed, in both instances, the Paris Court of Appeal rejected the opening of the safeguard proceedings which were initiated for the purpose of avoiding that loans be accelerated as a result of the occurrence of an event of default which was not related to operational difficulties but rather to the breach of covenants under the underlying loan agreements and with the aim of suspending generally the rights of secured creditors under the security interests granted in their favour.

With some caution, one may infer from the *Coeur Défense* and Mansford decisions that:

- it may be harder for a holding company which also carries out limited operational activities (such as owning and leasing real estate) to obtain the opening of safeguard proceedings based on pure financial difficulties that are unrelated to its operations (*e.g.,* breach of the undertaking under the loan documentation to enter into hedging arrangements by reason of post financial crisis deteriorated hedging conditions or breach of the "LTV" ratio tested at the level of the company, since such financial covenant relates to the value of the underlying property and the incurred indebtedness and does not necessarily reflect operational difficulties); and
- it should be harder for a company which is a mere holding company of the shares of a borrower (and neither a guarantor or a borrower itself) to obtain the opening of safeguard proceedings, where (i) the holding company's own obligations under the loan documentation are limited to a share pledge and (ii) the holding company's only liability is under a shareholders' loan, which is to be repaid *in fine* on its final maturity date or is automatically convertible into shares.

Even though these decisions have been rendered in the context of real estate financing transactions, they provide useful guidelines in the context of restructurings of other types of financings (in particular LBO transactions). These guidelines are also likely to be factored in when structuring new financing transactions.

If these decisions are confirmed by the French Supreme Court, this should have an even greater positive impact on the perception by investors of the debt market in France which had, in the current crisis, often been seen as unreasonably creditor-adverse, and further alleviate certain concerns that the international financial community had on the efficiency of French security packages.

Endnotes

[1] Paris Commercial Court 3 November 2008, RG n° 2008077996, Dame Luxembourg and RG n° 2008077997, SAS Heart of La Defense.

[2] Paris Court of Appeal 25 February 2010, RG n° 09/22756, Heart of La Defense (HOLD).

[3] Paris Court of Appeal 25 February 2010, RG n° 09/17248, SARL Mansford France Fund 1, etc.

[4] Article 3 of EC Regulation n° 1346/2000 of 29 May 2000 on insolvency proceedings.

[5] Article L.620-1 of the French Commercial Code. At the time the *Cœur Défense* insolvency proceedings were commenced, these difficulties (that it is not able to overcome) had to be "*of a nature leading to the suspension of payments*". This requirement was deleted by ordinance n° 2008-1345 of 18 December 2008.

[6] Beaune Commercial Court 16 July 2008, RG n° 2008001585.

[7] Paris Commercial Court 11 March 2009, RG n° 2009014452.

[8] With the notable exception of the Dailly security assignment referred to above.

[9] For ease or reference, this *Client Alert* refers just to the "FCT" (instead of referring to the Fonds Commun de Titrisation Windermere XII FCT as managed and represented by Eurotitrisation) when referring to the creditor of Hold under the loans.

If you have any questions about this *Client Alert*, please contact one of the members of the Finance and Restructuring & Insolvency Practice Groups listed below or the Latham attorney with whom you normally consult:

Xavier Farde
+33.1.40.62.23.12
xavier.farde@lw.com
Paris

Etienne Gentil
+33.1.40.62.21.25
etienne.gentil@lw.com
Paris

Hervé Diogo Amengual
+33.1.40.62.20.93
herve.diogoamengual@lw.com
Paris