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Belvédère Court of Appeal Decision Confirms Efficacy of Parallel Debt Mechanism Under French Law

Introduction

On 21 September 2010, the Dijon Court of Appeal[1] issued an important decision confirming the efficacy under French law of a "parallel debt" mechanism which had been used in the security package put in place as part of French issuer Belvédère's secured high yield issuance of May 2006.

"This is the first time that a French Court of Appeal recognizes the parallel debt mechanism in the context of security packages put in place as part of secured international financings granted to a French corporation."

French law has not, until recently, had a concept similar to the common-law trust concept. The trust concept permits (among other things) the holding and management of security by a trustee on behalf of a group of creditors. There was recently introduced under French law the concept of "*fiducie*" (articles 2011 *et seq.* of the French Civil Code), which has some of the characteristics of a trust, as well as a specific provision creating the notion of security agent (article 2328-1 of the French Civil Code). For various technical reasons, these new statutory provisions have not been embraced by French practitioners as efficient and practicable means of managing security interests in the way that a common-law security trust would allow.

In international financings involving security in France, the practice has often been for a number of years to use the parallel debt mechanism, in a way similar to its wide-spread use in Germany or The Netherlands. It has been seen as an efficient tool for the management of security interests granted in favor of a syndicate group of lenders and/or fluctuating group of bondholders (recently, in the Picard, Europcar and Novasep financings, for example). In the Belvédère bond issue, the parallel debt mechanism had been created under a collateral sharing agreement governed by New York law, and used in connection with security interests granted by the French issuer.

The qualifications which accompanied this practice, both in law firms' legal opinions and in legal risk factor disclosures in offering memoranda, had always emphasized that there was no judicial confirmation that parallel debt mechanisms worked.

This decision however constitutes a recognition by a French Court of Appeal of the parallel debt mechanism, which should be seen with increased confidence as a helpful tool to organize the holding of French law security in international financings — that is, until French law is able to provide a tool which practitioners determine provides similar comfort and advantages.

Main Characteristics and Advantages of a Parallel Debt Mechanism

Under a parallel debt mechanism, in addition to the obligor's prime obligation to pay or repay amounts owed by it to its creditors, the obligor undertakes in parallel to pay an equal amount to the security agent. This *parallel debt* is therefore an independent and separate debt owed to the security agent, which mirrors the debt owed to the secured finance parties under the finance documents. The documentation provides that any payments by the obligor to the security agent under the parallel debt discharges the obligors' debt to the lenders, and vice versa.

Parallel debt provisions include a statement that, if either the underlying obligations to the finance parties or the parallel debt is reduced, the corresponding debt is also reduced so as to prevent double recovery from the obligor of the same debt. The parallel debt may therefore at no time exceed the obligor's primary obligations towards the lenders.

All monies received or recovered by the security agent under the parallel debt are required to be applied in accordance with the "order of application" provisions (generally referred to as waterfall provisions) included in the relevant intercreditor agreement.

As a result of the existence of a parallel debt structure, any security for the obligations under the financing may be granted both in favor of the lenders and in favor of the security agent/parallel debt creditor, or indeed only in favor of the security agent/parallel debt creditor. The administration and enforcement of the security, granted with respect to the parallel debt, is much simplified, since it is unaffected by any change in the identity of the lenders. Also, it helps to deal with the requirement that certain types of French law security interest (*e.g.*, pledges of shares) clearly identify the beneficiaries at the time of the grant (including their registered names and registered office), which may be an impossible task in some instances, such as the case where upon issue the proceeds of a high yield are paid into an escrow account, to be released only at a later date upon certain conditions having been met (such as an acquisition or a refinancing occurring), *i.e.,* at a time when it is no longer possible to identify specifically the beneficiaries to be secured.

The Belvédère Court of Appeal Decision

In May 2006, Belvédère SA (Belvédère), an international beverage company principally producing vodka, spirits and wine, issued €375,000,000 Floating Rate Notes (FRN) repayable in 2013. The FRN were governed by an indenture entered into among Belvédère and certain of its subsidiaries, The Bank of New York Mellon as trustee, Natixis SA (France) as security agent for the French law security documents and Raiffeisen Bank Polska (Poland) as security agent for Polish law security documents. There was also entered into a New York law governed collateral sharing agreement, creating a parallel debt obligation from Belvédère and the relevant subsidiaries towards each security agent acting as creditor for its own account (and not as representative for the other finance parties). The collateral sharing agreement also provided that the aggregate amount of debt owed by Belvédère and its subsidiaries would not be modified as a consequence of the parallel debt, to avoid that any amount should become payable twice to the security agent and to the finance parties.

In July 2008, French safeguard (*i.e.,* insolvency-type) proceedings were commenced against Belvédère and its subsidiaries. Creditors whose claims arose prior to the commencement of these proceedings had to file their claims within a specified period of time.

Natixis SA as security agent declared its own claim against Belvédère and its subsidiaries pursuant to the parallel debt provisions included in the collateral sharing agreement. The FRN holders also declared their claims separately.

Ruling on the admissibility of the claims from the various creditors of Belvédère as part of its safeguard proceedings, the Court of Appeal held that:

- The existence and characteristics of the claim must be determined pursuant to the applicable conflict of laws rule, which in this case led to the application of the law governing the collateral sharing agreement, *i.e.,* New York law.

  The Court held that the law of the state in which the insolvency proceedings have been commenced, *i.e.,* French law, should determine the rules governing the lodging, verification and admission of the claim, in accordance with article 4 of EC Regulation n° 1346/2000 of 29 May 2000 on insolvency proceedings, but should not determine the existence and characteristics of such claim (contrary to what had been argued by Belvédère).

- The parallel debt mechanism provided for in the collateral sharing agreement was not incompatible with French internal or international public policy (*ordre public interne ou international*) rules, and in particular with the principle of equal treatment of creditors of a same class in safeguard or insolvency proceedings.

  The Court stressed that the New York law parallel debt mechanism was similar to the French concept of "*solidarité active*" provided for by article 1197 of the French Civil Code, which provides that any creditor is entitled to claim the payment of the aggregate amount of the receivable, the payment being made to any such creditor releasing the debtor from such claim *vis-à-vis* the other creditors of the claim.

  Finally, it was stressed that the parallel debt provisions included in the documentation did not create any artificial debt ("*passif artificiel*"), nor any risk of double payment of the claim.

Conclusion

The Finance community should remain somewhat cautious in drawing definitive conclusions from this caselaw, since the Dijon Court of Appeal decision is being appealed by Belvédère before the French Supreme Court (*Cour de Cassation*). In addition, one may not infer from the decision that a parallel debt mechanism could be created under a French law governed agreement.

Nevertheless, this decision is important for the Finance community, since this is the first time that a French Court of Appeal recognizes the parallel debt mechanism in the context of security packages put in place as part of secured international financings granted to a French corporation. If this decision is confirmed by the French Supreme Court, this will bring more certainty as to the efficiency of the use of this mechanism for the management of security packages granted by French borrowers or issuers as part of international financing transactions.

Endnotes

[1] Dijon Court of Appeal, 21 September 2010, RG n° 09/02080.

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