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Coeur Défense Safeguard Proceedings: lessons to be learnt from the French Supreme Court Decision

Introduction

On 8 March 2011[1], the French Supreme Court issued an important decision for the restructuring, finance and private equity communities and their advisers in connection with the on-going litigation surrounding the *Coeur Défense* restructuring.

Since the Paris Commercial Court opened safeguard proceedings with respect to Heart of La Défense SAS (**Hold**) and Dame Luxembourg (**Dame**)[2] in November 2008, lenders have been concerned that sponsors/borrowers in LBOs and structured finance transactions would attempt to use the French safeguard proceedings (*procédure de sauvegarde*) regime to gain leverage over lenders in restructuring negotiations by neutralizing (or threatening to neutralize) the enforcement of their security package.

The Paris Court of Appeal decision of 25 February 2010[3], rescinding the opening of the safeguard proceedings of Hold and Dame, had provided some relief to lenders in that respect. Hold and Dame challenged the Paris Court of Appeal decision before the French Supreme Court (*Cour de Cassation*). Since then, the situation was closely watched and the uncertainty it generated led in particular to lenders requesting the implementation of so-called "Double Luxco structures" in new, sizeable French-based leveraged financings in order to increase the effectiveness of their security packages.

The French Supreme Court decision of 8 March 2011 overturned the Paris Court of Appeal decision of 25 February 2010 with respect to the Court of Appeal's rescission of the safeguard proceedings of Hold and Dame. This decision contains important rulings regarding the opening of safeguard proceedings including:

- individual creditors that have specific grounds to invoke are allowed to challenge the commencing of safeguard proceedings;
- difficulties experienced by the debtor are not required to be "operational" difficulties;
- the Court must verify carefully whether the difficulties experienced by the debtor are "*difficulties that it is not able to overcome*"; and
- the motivations of a debtor for requesting the opening of safeguard proceedings are not to be taken into consideration by the Court (except where motivations are fraudulent).

This decision is important for restructurings of French incorporated holding companies, and also for cases brought into France by reason of a "COMI shift" since French insolvency courts have jurisdiction

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to open safeguard proceedings against French entities, but also against entities which, while not incorporated in France, are shown to have their center of main interests (**COMI**), as defined by European regulations[4], located in France. In the *Coeur Défense* decision, Dame had its registered seat located in Luxembourg, but requested the opening of safeguard proceedings in France, arguing, successfully, that its COMI was situated in France.

Background: Safeguard Proceedings

A company that is eligible 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]. At the time the *Cœur Défense* insolvency proceedings were commenced, such difficulties had to be "*of such a nature as to lead to the suspension of payments*". This requirement was deleted by ordinance n° 2008-1345 of 18 December 2008. The term "difficulties" as used in this context is not defined in the French Commercial Code.

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.

Secured creditors in particular are 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 it 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[6]; 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

The *Coeur Défense* complex — one of the largest office complexes in Europe located in the center of the Paris *La Défense* financial district — was acquired in 2007 by Hold, a special-purpose vehicle registered in Paris, which is owned by Dame, a Luxembourg holding company.

The acquisition was financed by two loans in an aggregate principal amount of €1.64 billion. These loans were subsequently transferred by way of a securitization to the *Fonds Commun de Titrisation* Windermere XII FCT[7], managed and represented by Eurotitrisation, and which therefore became the sole creditor under these loans. 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 of its shares in Hold.

Two Lehman Brothers entities (in the UK and in the US) 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 entities providing the hedging, itself triggering an obligation upon Hold under its loans to substitute an alternative hedging arrangement with another counterparty.

Having failed to provide such an alternate hedge, Hold was notified of the existence of an event of default (although the loans were not accelerated) and decided to request the opening of safeguard proceedings from the Paris Commercial Court. A similar request was made by its holding company, Dame.

The Paris Commercial Court granted Hold's and Dame's request on 3 November 2008 which resulted in an automatic stay on judicial actions against them and a stay on enforcement proceedings over their assets.

The FCT challenged the court decision to open safeguard proceedings with respect to Dame and Hold, arguing that safeguard proceedings were not warranted under the circumstances.

On 25 February 2010, the Paris Court of Appeal rescinded the decision of the Paris Commercial Court opening safeguard proceedings in favor of 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 of such a nature as to lead to the suspension of payments — see above) was not met. The Court also 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*).

Hold and Dame challenged the Paris Court of Appeal decision before the French Supreme Court (*Cour de Cassation*). The French Supreme Court rendered its decision on 8 March 2011 partially rescinding the Paris Court of Appeal decision of 25 February 2010[8].

Individual creditors that have specific grounds to invoke are allowed to challenge the commencing of safeguard proceedings

The 8 March 2011 French Supreme Court decision clearly validates the principle that individual creditors are allowed to challenge the court decision commencing safeguard proceedings provided that they have grounds to do so which are specific and distinct from those of creditors generally[9]. Under the circumstances, the French Supreme Court held that the FCT's arguments that Hold and Dame had used safeguard proceedings for the sole purpose of avoiding their contractual obligations *vis-à-vis* the FCT and in an attempt to impose on the FCT a modification of the loan agreements were specific to the FCT. Hold had almost no creditors outside its group[10] other than the FCT and Dame had almost no creditors besides the FCT and its shareholder[11]. This specific set of circumstances makes it difficult to consider that creditors in general would be entitled to challenge the opening of safeguard proceedings by arguing that the proceedings had been commenced by a borrower or guarantor in order to avoid his contractual obligations (e.g. in order to neutralize the enforcement of the creditors security package).

Difficulties experienced by the debtor are not required to be "operational" difficulties

The Paris Court of Appeal had characterized the difficulties that should exist in order to justify the opening of safeguard proceedings as needing to be "*operational*" difficulties. It ruled that neither Hold nor Dame were facing operational 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. This interpretation by the Paris Court of Appeal, had it been upheld by the French Supreme Court, would have had the effect of substantially reducing the types of corporations which could seek safeguard protection, in particular excluding pure holding companies such as Bidcos or Holdcos in leveraged or structured financings.

The French Supreme Court overruled the Paris Court of Appeal on the grounds that the French Commercial Code does not require that difficulties affect the debtor's business in order for safeguard proceedings to be opened.

Court shall verify whether difficulties experienced by the debtor are *"difficulties that it is not able to overcome"*

To lift the safeguard proceedings of **Hold**, the Paris Court of Appeal also held that Hold was facing unanticipated circumstances which rendered the performance of the hedging covenants more onerous, but not impossible.

The French Supreme Court overruled the Paris Court of Appeal because it mischaracterized Hold's argument that it was impossible in 2008 for it to find a counterparty for its hedging agreements due to the absence of market at that time, by holding that Hold had argued that it was only more onerous for her to do so. This issue has to be considered by the Versailles Court of Appeal which will re-try the matter.

Similarly, regarding **Dame**, the Paris Court of Appeal did not pay due consideration to Dame's argument that the loss of its shareholding in Hold (as a result of the enforcement of the creditors' contractual right to enforce collateral) together with the potential acceleration of the shareholders' loans of an amount of €249,000,000 constituted difficulties that Dame was not able to overcome "*of a nature leading to the suspension of payments*"[12]. This issue will also have to be considered by the Versailles Court of Appeal.

When structuring transactions, consideration should be given to providing that shareholders' loans may not be accelerated or that they shall automatically be converted into equity under certain circumstances in order for it to be difficult for a holding company such as Dame to demonstrate "*difficulties that it is not able to overcome*" based on the existence of shareholders' loans.

The debtor's motives in requiring safeguard protection are not controlled by the Court (except in the event of fraud)

The French Supreme Court held that, except in the event of fraud:

- provided that a debtor (Hold) proved that it experienced "*difficulties it is not able to overcome*", such debtor was entitled to be placed under safeguard proceedings protection notwithstanding that the consequence of these proceedings was that it would avoid its contractual obligations under the loan agreement; and
- provided that a grantor of credit support (Dame) proved that it experienced "*difficulties it is not able to overcome*", such grantor was entitled to be placed under safeguard proceedings protectionnotwithstanding that the consequence of these proceedings was that they wouldparalyze creditors' contractual right toenforce collateral and that, as a result, the grantor of credit support would avoid losing the control of its subsidiary.

The French Supreme Court considered that, as French law does not provide that safeguard protection is conditional upon a debtor's motives, such motives are, save fraud, irrelevant.

Conclusion

The French Supreme Court decision clearly confirms the possibility for individual creditors that have specific grounds to invoke to challenge the judgment placing a debtor under the protection of safeguard proceedings.

However, the French Supreme Court refuses to limit the difficulties which may be invoked by a debtor in order to be placed under safeguard to those which are "*operational*" in nature. Potentially therefore any type of difficulties may be invoked, including financial difficulties.

Although it is premature to draw any conclusions at this stage, in particular

before the Versailles Court of Appeal rules on the matter, it would seem that a holding company may obtain the protection of safeguard proceedings based on financial difficulties that are unrelated to the running of its business. It may however be more difficult for such an entity that would be a pure holding company whose only creditors would be its shareholders to prove that "*it is not able to overcome*" such financial difficulties if such shareholders' loans may not be accelerated or alternatively shall automatically be converted into equity if the company experiences serious financial difficulties.

The issues which are part of the *Coeur Défense* saga are not yet resolved[13]. The financial community remains wary of debtors attempting to use safeguard proceedings to gain leverage over their lenders in restructuring negotiations, by neutralizing (or threatening to neutralize) the enforcement of their French security package.

It is therefore likely that lenders will, if circumstances permit, continue to turn to the new structures that have been developed since 2009, enhancing the efficiency of the security package granted to secured parties even though the borrower and/or its credit support providers are subject to safeguard proceedings. Large and mid-market LBO financings originated in France since 2010 are now often structured to include "Double Luxco" ownership and security structures, which enhance the ability of the secured parties to enforce part of the security package in order to take indirect control of French Bidco through its grand-parent in Luxembourg.

Endnotes

1 Cass. Com. 8 March 2011 n° 10-13.988, 10-13.989 and 10-13.990.

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

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

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.

6 With the notable exception of the *Dailly* security assignment referred to above, the enforcement of which is not prohibited.

7 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.

8 The French Supreme Court remanded the case to the Versailles Court of Appeal for judgment.

9 Article L. 661-2 of the French Commercial Code and article 583 of the French Code of Civil Procedure.

10 The FCT's claim on Hold represented around 80 percent of Hold's total liabilities to its creditors and 97 percent of its liabilities to creditors outside its group.

11 With respect to a shareholder loan, the repayment of which was subordinated to payment of amounts due to the FCT.

12 Which was, at the time the "*Coeur Défense*" proceedings were opened, an additional requirement to be met in order for safeguard proceedings to be opened against a company.

13 The French Supreme Court sent other issues of the case back to the Versailles Court of Appeal, including the issue of the ownership of the receivables under the property complex leases, which had been assigned to the FCT by way of a French *Dailly* law security assignment of receivables.

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