Enforceability of security subject to an EU law different from Spanish law in the framework of insolvency procedures in Spain: an actual case

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Introduction

This article deals with the enforceability of security subject to a European Union law different from Spanish law in the framework of insolvency procedures in Spain and is inspired by an actual case that caused some concern over lenders (particularly banks and international funds lending in Spain). Those concerns were the result of a first instance court resolution, which prevented the enforcement of Luxembourg law security based on the financial collateral regulation in the framework of an insolvency procedure in Spain. An appeal court settled the matter and allowed the enforcement, in line with a correct interpretation of the Spanish and EU insolvency regulation.

The case

Alteco, SL (the 'Debtor') was a private wealth vehicle which entered into a loan agreement with a number of Spanish and international banks on 7 May 2006 (the 'Loan Agreement'). Such financing was secured on 25 May 2009 with a pledge over certain shares of the French company Gecina SA (the 'Shares') owned by the Debtor (the 'Pledge'). The Pledge was subject to Luxembourg law on the basis that the Shares were deposited with Credit Agriculture Luxembourg SA in Luxembourg and in accordance with the terms of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (the 'Financial Collateral Directive').

The Loan Agreement was amended on 30 January 2012, allowing for new events of enforcement of the Pledge (the 'Amendment'). The Debtor filed for bankruptcy on 1 June 2012, and following the declaration of insolvency on 11 October 2012, the Debtor was informed that on the basis of the terms of the Amendment, the Pledge would have been enforced.

The insolvency administration of the Debtor claimed against such enforcement. First, it requested the rescission of the Amendment on the basis that it was agreed at a time when the Debtor was already insolvent (but before the filing of such insolvency), and that, therefore, it was detrimental for the other creditors of the Debtor. Additionally, and in line with the rescission request, it claimed that an injunction was granted to prevent the enforcement of the Pledge. Such injunction, due to the urgency of the case, was to be taken without a hearing to the beneficiaries of the Pledge.

The insolvency judge of the Commercial Court number 8 in Madrid (the 'Insolvency Judge') agreed to the above request on 18 October 2012 (the 'First Instance Resolution'). The First Instance Resolution set forth that the requirements to grant interim measures appeared in the case. Those requirements under Spanish law are: (1) the appearance of a good right of the request (*'fumus boni iuris'*); and (2) the danger of delay if the enforcement was not prevented (*'periculum in mora'*) (ie, enforcement taking place and thus risk of proceeds therefrom or of the Shares disappearing from the Debtor estate). The Insolvency Judge agreed to the reasoning of the insolvency administration and added that on the basis of Article 4[1] and Article 5.4[2] of Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings (the '2000 Insolvency Regulation'), this security could be subject in respect of rescission actions to the regulation of the country in which the insolvency procedure is conducted, that is, Spain, instead of its applicable law, that is, Luxembourg law.

The beneficiaries of the Pledge claimed against the First Instance Resolution, but the Insolvency

Judge ruled against such a claim. The First Instance Resolution was appealed before the Madrid Provincial Court and was finally revoked (the 'Provincial Court Resolution') on 3 March 2014.

Legal analysis

In order to fully understand the First Instance Resolution and Provincial Court Resolution, it is necessary to refer to the 2000 Insolvency Regulation, applicable at the time of the declaration of insolvency of the Debtor. The 2000 Insolvency Regulation (as Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, which applies to procedures opened after 26 June 2017) establishes a uniform framework to cross-border applicable law issues within insolvency procedures in the EU.

Article 5 of the 2000 Insolvency Regulation deals with the interaction between the opening of an insolvency procedure in a certain jurisdiction, and in rem rights of a creditor subject to the law of a different jurisdiction:

> 'The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets – both specific assets and collections of indefinite assets as a whole which change from time to time – belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings'.

The Pledge fits within this description: at an insolvency procedure in Spain, it was a rightin rem of certain creditors of the Debtor with respect to moveable assets situated in Luxembourg, and thus such right should not be affected per se by the opening of such an insolvency procedure.

What should be the competent court? It seems undisputed that, in the case at hand, the Spanish courts were competent to deal with the insolvency of the Debtor as the centre of main interest of the Debtor was in Spain (as per Article 3 of the 2000 Insolvency Regulation).

And what about the applicable law to the procedure and to the rescission of the Pledge? According to Article 4 of the 2000 Insolvency Regulation, the general rule is that such applicable law will be that of the jurisdiction in which the insolvency procedure is opened, that is, Spanish law in this case. Such law will also apply to 'to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors' (Article 4(2)(m)): therefore, to the rescission of the Pledge. And this is the key to the confusion; because Article 13 of the 2000 Insolvency Regulation, which was not considered by the first instance court, includes an exception to the above general rule:

> 'Article 4(2)(m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that the said act is subject to the law of a Member State other than that of the State of the opening of proceedings, and that law does not allow any means of challenging that act in the relevant case'.

In light of the above, Luxembourg law should have applied to the rescission of the Pledge and thus would have prevented the rescission and the stay on enforcement because the beneficiaries to the Pledge were actually in a position to evidence (as they did in appeal) that: (1) the Pledge was subject to Luxembourg law;[3] and (2) Luxembourg law does not allow the prevention of enforcement of collateral even in the framework of an insolvency procedure, as per Article 20 of Luxembourg law of 5 August 2005 on financial collateral arrangements.

The beneficiaries of the Pledge, which could evidence both circumstances of Article 13 at the appeal court (and thus avoid the application of Spanish law), were unable to provide such proof at the first instance court because the injunction was decided without a hearing.

The appeal court decided that the injunction (which prevented the applicability of the 2000 Insolvency Regulation) and, subsequently, the stay on enforcement were wrongfully granted. First, because in the opinion of the appeal court, the amendment of the Pledge was not detrimental to other creditors of the Debtor. Second, because there was not a real appearance of a good right of the request ('*fumus boni iuris*') because the court did not assess properly the interaction between Article 4(2)(m) and Article 13 of the 2000 Insolvency Regulation. Additionally, even under Spanish law the enforcement of the Pledge could not have been stayed because the Spanish financial collateral regulation requires that an insolvency administration can only request the rescission of financial collateral arrangements if it can evidence that they were granted in fraud of creditors. Finally, the appeal court decided that the danger of delay if the enforcement was not prevented ('*periculum in mora*') did not apply in this case because it was the parties' agreement regarding the Pledge that enforcement would apply in an event of default, which was the case at hand.

In light of the above, it seems clear that the application of the 2000 Insolvency Regulation (as of Regulation (EU) 2015/848 when in force) would have allowed the peaceful enforcement of the Luxembourg law Pledge over the Shares in a Spanish insolvency procedure.

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Notes

1 Article 4 of the 2000 Insolvency Regulation:

'Law applicable

1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the "State of the opening of proceedings".

2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular:

(a) against which debtors insolvency proceedings may be brought on account of their capacity;

(b) the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings;

(...)

(e) the effects of insolvency proceedings on current contracts to which the debtor is party;

(f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending;

(...)

(h) the rules governing the lodging, verification and admission of claims;

(i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;

(...)

(m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors'.

2 Article 5 of the 2000 Insolvency Regulation:

'Third parties' rights in rem

1. The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets – both specific assets and collections of indefinite assets as a whole which change from time to time – belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings.

2. The rights referred to in paragraph 1 shall in particular mean:

(a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;

(b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;

(c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;

(d) a right in rem to the beneficial use of assets.

3. The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of paragraph 1 may be obtained, shall be considered a right in rem.

4. Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m).

3 The Pledge was subject and could be subject to Luxembourg law because the Shares were represented by book entries and were deposited in Luxembourg. The legal reasoning is at Art 17 of Royal Decree Law 5/2005, which transposed into the Spanish regulation the Collateral Directive. This piece of regulation is consistent with Luxembourg law of 5 August 2005, on Financial Collateral, which transposed the Collateral Directive into Luxembourg law.