

Commercial Property - France

Legal issues surrounding property security packages

Contributed by **NMW avocats**

July 06 2012

Introduction

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Lessons from *Coeur Défense*

Introduction

Since the beginning of 2012, the French real estate market has been split between borrowers with an increased need to refinance, and lenders which have lost confidence in financing and refinancing under the French legal system. The real estate market is dealing with two major requirements:

- the need to refinance real estate loans; and
- the need to reassure financial institutions as to the quality and efficiency of the structure of their security packages.

An increasing number of real estate lenders are reluctant to make investments and provide financing and refinancing, and much of this reluctance seems to have stemmed from the Supreme Court's decision in *Coeur Défense*, which lenders believe shows favouritism to debtors under French law to the detriment of financial institutions.

In addition, a high level of debt is due to mature during 2012 and banks need to reduce their commitments because their debt-to-equity ratio is excessive.

However, debtors are not as favoured under French law as it may appear. Thus, foreign real estate players need to be aware that there are legal means of protection available to them in case of debtors' default and bad faith.

Facts

Joint stock company Heart of La Defense (HOLD), whose capital is wholly owned by a holding company, Dame Luxembourg, acquired the Coeur Défense office building for rental through a real estate partnership.

Having financial difficulties, HOLD and Dame Luxembourg filed a petition to open reorganisation proceedings under insolvency legislation. The initial court decision was favourable to the lenders, holding that:

- the debtor had misused the reorganisation legislation; and
- a Luxembourg holding company could not benefit from the French reorganisation legislation applicable only to companies established in France.

On March 8 2011 the Supreme Court upheld the appeal, and asked the Versailles Court of Appeal to reconsider the case (10-13.988). On January 19 2012 the Versailles Court of Appeal ruled in favour of the debtor (11/03519).

Both courts stated that the opening of reorganisation proceedings cannot be denied if the debtor demonstrates difficulties that it is unable to overcome and which are likely to result in it defaulting on payments (eg, mortgage or rental payments). Creditors cannot be protected from the opening of reorganisation proceedings for a French company owning a building in France simply through the establishment of a special purpose entity located in another European jurisdiction.

Lessons from *Coeur Défense*

In light of *Coeur Défense*, players on the real estate market should consider overcoming the issues raised in the case by reversing the 'normal' financing package -

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that is, the subsidiary becomes the lender and the parent company grants the guarantee.

Under this method, the holding company borrows to finance its subsidiary by capital contribution and by one or more loans. Collateral and guarantees are granted to both the holding company and the subsidiary:

- at the holding company level, the loan is guaranteed by a mortgage on all real estate, an independent guarantee and a fiduciary assignment of future rent; and
- at the subsidiary level, the loan is guaranteed by a pledge of the holding's shares in subsidiary with a resolutive clause and the subscription of contracts hedging the interest rate.

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