ENTITLEMENT TO BRING LEGAL ACTIONS IN SYNDICATED FINANCING: JUDGMENT OF THE MADRID PROVINCIAL COURT OF 21 APRIL 2017

AUCOSTA, the concessionaire company of a toll motorway in Spain, was insolvent. Its main creditor was a syndicate of banks which in 2004 had granted it project finance for up to 450 million euros. In this context, some of the lender entities (18 of the initial 29) brought a claim against the insolvent company, raising - for the first time in the courts - a fundamental issue in the world of project finance regarding **negative covenants**; in this case, the debtor's prohibition from opening current accounts other than those authorised in the facility agreement. *To what extent is the typical negative covenant in the facility agreement enforceable?* Regrettably, the court does not ultimately resolve this issue.

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BACKGROUND

The syndicated project finance agreement contained the series of standard clauses and covenants described, and among them, the negative covenant prohibiting the debtor from opening other current accounts different from those defined in the agreement as "Project Accounts".

AUCOSTA declared insolvency and the insolvency receivers proceeded to immediately: (i) open a new current account at Deutsche Bank, and (ii) deposit there both the revenue from the toll motorway received by AUCOSTA after its declaration of insolvency, as well as the balances of the other current accounts AUCOSTA had opened as established in the facility agreement, which had been pledged in favour of the lender entities.

This is the context in which some lender entities made their claim, seeking that the court: declare a breach by the insolvency receivers, order the closure of the new current account, and give instructions for its balance to be re-allocated to the previously-existing accounts.

JUDGMENT OF THE MADRID PROVINCIAL COURT OF 21 APRIL 2017

It is regrettable that the judgment of the Madrid Provincial Court did not ultimately resolve the issue of the enforceability of negative covenants, because the actual subject of its decision is a different matter altogether (although

likewise interesting): the active *locus standi* or entitlement to bring the legal action in question.

Clause 6.2 of AUCOSTA's syndicated facility agreement discussed taking legal action, establishing as follows:

"6.2 Court and out-of-court actions

Any of the Lender Entities may take out-of-court actions, pursuant to the terms of this Agreement, in an attempt to maintain and defend their own rights and those of the other Lender Entities. However, each Lender Entity may take court actions to exercise only its own rights in the terms of Clause TWENTY-ONE (EARLY MATURITY), notwithstanding the powers granted to the Agent herein".

This clause establishes when a company can take legal actions against the debtor: when declaring the early maturity of the loan. What the clause fails to specify is just who can take legal actions outside the case of early maturity, although it adds "*notwithstanding the powers granted to the Agent herein*".

The facility agreement contains an express provision regarding this aspect in Clause 22.7 (i), which, after establishing the duties of the Agent, sets out the undertaking by each of the Lender Entities to "*jointly exercise, together with the Agent and in the same proceedings, all actions and claims which, according to this Agreement, correspond to the Lender Entities*". Based on the wording of this latter provision, it seems that indeed, except in the case of a declaration of early maturity, for all other potential legal actions in relation to the facility agreement, Clause 22.7 (i) establishes that legal actions are to be brought jointly, through the Agent. This being the case, it is incorrect to interpret that the claim was brought by only 18 of the 29 entities comprising the AUCOSTA syndicate and that the Agent bank, Unicaja, was not even included among the plaintiffs. The conclusion we can make from the above is that it is important to consider, when negotiating the agreement, not only the advantages, but also the disadvantages that would derive from attributing certain exclusive powers to the Agent, to act in the creditors' interest.

MERITS OF THE CASE

The Judgment does not pronounce on the insolvent party's opening of a new current account. We understand that the justification for breaching the negative covenant contained in the facility agreement (the prohibition against opening new current accounts) is the appeal to the "interest of the insolvency proceedings". It would seem to be an attempt to protect the insolvent party's revenue after the declaration of insolvency and thereby achieve the necessary liquidity so as to enable it to continue to operate (being thus able, for example, to use its assets to pay off its debts, including the debts of the insolvency receivers themselves).

Actually, this debate is even more complex than that. The question arises as to where the toll revenue flowing into the insolvent company's accounts will be allocated to after the declaration of insolvency, revenue which was originally pledged in favour of the lender entities. There should be no doubt that the balance of the accounts at the time when AUCOSTA declared insolvency is pledged to the lender entities.

In conclusion, when considering how a toll motorway is financed, it is important to determine if the insolvent party's revenue was pledged *ab initio* i.e. from the

outset, as normally occurs in the case of shadow toll motorways. If this is the case, it could be defended that the pledge is enforceable, as the pledge should not be affected by the fact that the revenue is deposited into one account or the other (the breach of the negative covenant should not permit the pledge to be evaded). However, if the toll motorways were not pledged, it would be difficult to defend that the toll revenue earned following the declaration of insolvency should be allocated to the holders of the pledge. The prohibition against opening other current accounts is merely an obligation *inter partes* i.e. between the parties, which the insolvent party breaches on the basis of this being in the interest of the insolvency proceedings.

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