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# Espirito Santo and the revival of the controlled management procedure

Martine Gerber-Lemaire asks whether this old-fashioned tool can rescue the Espirito Santo group



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**I**t happens in the best of families. The Espirito Santo family, however, hasn't encountered trouble for the first time.

In the 1970s, when major industries in Portugal were nationalized, including Banco Espirito Santo, leading members of the family fled into exile, where they restarted their fortune. That is how ESI holding was incorporated in 1975 in Luxembourg, the top holding company of the Espirito Santo Group (**GES**), to be followed by two main sub-holdings: Espirito Santo Financial Group (1984) and Espirito Santo Resources (1983), which was to become Rio Forte in 2009.

Almost 40 years later, on 18 July 2014, first Espirito Santo International S.A., which holds 20% of Banco Espirito Santo S.A., asked for controlled management in Luxembourg, after it had been declared in serious financial condition following an audit ordered by Portugal's Central Bank. Not even a week later, on 22 July, Espirito Santo Financial Group S.A., which is 49% held by Espirito Santo International, and Rio Forte Investment S.A. filed for creditor protection, the latter failing to make a €897 million debt payment to Portugal Telecom.

As negative news on the Espirito Santo group accumulate, it is difficult to predict the outcome of the ruling on the future of the group, which is scheduled for 8 October. Although The Portuguese Central Bank has decided to grant €4.9 billion from its resolution fund to rescue Banco Espirito Santo, it is

still open whether the Luxembourg judge, based on the opinion of experienced experts analyzing the case (who were involved in the suspension of payment process of three major Icelandic banks in Luxembourg in 2008 and also in the Madoff cases) will allow the three Luxembourg entities to continue their activities after restructuring or if they will be subject to wholesale liquidation and bankruptcy.

Little known and used, controlled management, governed by the Grand Ducal Decree dated May 24, 1935<sup>1</sup> (the "**Decree**") is considered as an old-fashioned or obsolete tool. Is that still the case?

Relatively old and largely inspired from Belgian law<sup>2</sup>, controlled management is an alternative for traders – either natural or legal persons – facing a crisis, but wanting to avoid bankruptcy, which is deemed too drastic, or composition with creditors to avoid bankruptcy (*concordat*), which in its turn is criticized for its lack of flexibility. In concrete terms, its benefit is available to entrepreneurs or companies which have either lost their creditworthiness or are having difficulties in meeting all their commitments.

Contrary to bankruptcy, controlled management is not available if the applicant has already been declared bankrupt by final judgment<sup>3</sup>. The application of a controlled management procedure must be used to obtain a re-organization of the business or a better realization of the assets of the applicant<sup>4</sup>.

While it is a condition required by Belgian law that the

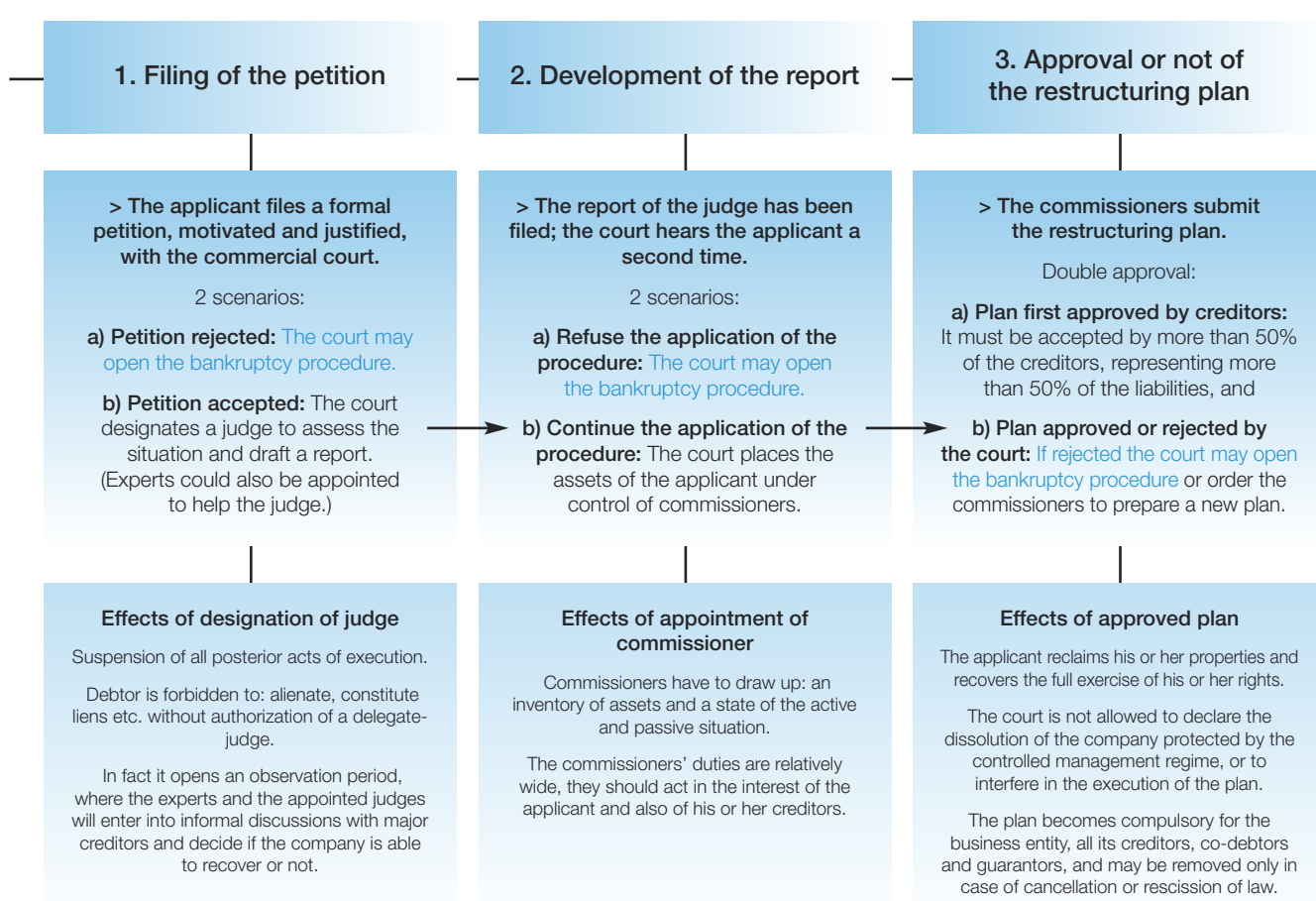
trader act in good faith, the Luxembourg legislator refused to introduce this mention in the Decree. According to the latter, "*the desire to safeguard general interest must prevail over the interest of the trader*". However, judges take it into account and may refuse the benefit of the regime to applicants who appear to have committed fraud or gross mistakes in the management of their business<sup>6</sup>.

With the Espirito Santo cases, the rumour of embezzlement is very strong; indeed investigations were opened by both Portuguese and Luxembourg public prosecutors. Therefore some doubts subsist on the good faith of the management, but the European banking sector motto "*too big to fail*" has certainly been applied by the Luxembourg Court in order to give time to the Portuguese bank to find a proper solution.

It would also be interesting to follow this case to ascertain if the ironic motto of certain discouraged creditors would apply as well: "*too big to go to jail*". Let us hope that the Luxembourg public prosecutor will have taken into account the recommendation of his Portuguese colleague and shall exercise caution in relying on the declarations of the directors, shareholders and various managers of the Luxembourg entities. Indeed there has been an interesting sudden new development in the liquidation case of Landsbanki Luxembourg. On 10 July 2014, Luxembourg's Court of Appeal gave an unexpected judgment in relation with alleged criminal offences recognized in other countries but not prosecuted under

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Luxembourg court. The court overturned an order of the investigating judge which had ruled that the time limit to prosecute had been reached in respect of facts alleged in a criminal complaint filed by a group of 108 plaintiffs against, among others, Landsbanki. More interesting is a direct claim against the liquidator for alleged offence of money-laundering. Therefore it seems that the time of indulgence is over in Luxembourg courts and the public prosecutor's office.

In any case, the resurgence of interest in controlled management leads to an explanation of the three distinct stages of this mechanism summarized in the timeline with several milestones. (See chart above.)

### Court hearing

The next Court hearing for Espirito Santo will take place on

8 October 2014, and the test of having controlled management used for rescuing holding companies could turn out successful or not.

Luxembourg courts are highly pragmatic; the Decree is quite flexible and if there is an opportunity for the whole group to be rescued instead of simply being liquidated, chances are that the formal controlled management procedure will be opened. It seems that some distress funds have offered to finance the group during the "observation period". The suspension of negotiation of certain financial papers declared by the CSSF (Luxembourg financial regulator) on 4 August 2014 was revoked on 18 August; maybe these are clues for a happy end.

Nevertheless, on the other side, everything is in the hands of

the Portuguese financial regulator and if the Portuguese bank can be rescued without its holding companies, bankruptcy proceedings will replace controlled management and it will be only pruning branches of the big Espirito Santo tree. Let's hope that it is not also sawing off the branch that creditors are sitting on... ■

#### Footnotes:

- 1 Grand-Ducal Decree dated May 24, 1935 supplementing the legislation on suspension of payments, preventive concordat of bankruptcy by the institution of the system of controlled management.
- 2 Belgian Royal decree dated October 15, 1934, repealed on December 31, 1936
- 3 Idem.
- 4 Court of Appeal of Luxembourg, November 19, 1986
- 5 HOMMEL L. et LEVÉQUE F., « La gestion contrôlée », 1934, p.22, n° 7
- 6 Court of Appeal of Luxembourg, February 17, 1982



**IF THERE IS AN OPPORTUNITY FOR THE WHOLE GROUP TO BE RESCUED CHANCES ARE THAT THE FORMAL CONTROLLED MANAGEMENT PROCEDURE WILL BE OPENED**

