Decoding Arbitral Disputes: Cross-Border Contract Lessons

By **Josep Galvez** (December 16, 2024)

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This article is part of a regular column that delves into the most critical cross-border investment and commercial European disputes over arbitral award enforcement. In this installment, I discuss the implications of the English High Court's decision in Banco de Sabadell SA v. Cerberus Global NPL Associates LLC.

The High Court of Justice decision in Banco De Sabadell SA v. Cerberus Global NPL Associates LLC represents a landmark ruling in the domain of cross-border contractual interpretation.

Delivered by High Court Judge Andrew Baker on Dec. 4, the case concerned the interpretation of complex deferred payment mechanisms in joint venture agreements valued at billions of euros. These agreements involved the transfer of Spanish real estate owned assets, or REOs, under contracts governed by Spanish law but guaranteed under English law, adding a multilayered cross-jurisdictional element to the dispute.

The judgment revolved around the proper construction of provisions governing deferred purchase price payments, particularly whether such payments were due based on fair market value adjustments for certain REOs that remained unregistered beyond agreed maturity dates.

The dispute involved the intersection of commercial imperatives and the enforceability of deferred payment clauses in highly negotiated contracts between sophisticated parties.

The significance of this case extends beyond its financial stakes. It highlights the increasing complexity of cross-border joint venture agreements, the importance of clear drafting, and the role of English courts in adjudicating disputes particularly under foreign laws.

It also provides guidance on interpreting deferred payment clauses and balancing competing commercial imperatives, making it essential reading for practitioners involved in international transactions and finance.

Background to the Dispute

In July 2018 and August 2019, Banco de Sabadell entered into three investment agreements, Coliseum, Challenger and Rex, with entities backed by the Cerberus group, a tenured global investor in real estate and real estate-related assets.

These agreements were designed to offload Sabadell's substantial portfolio of Spanish real estate owned assets, many of which were nonperforming due to the financial crisis and subsequent bank acquisitions by Sabadell, including the Caja de Ahorros del Mediterráneo and Banco Gallego. The REOs were transferred into joint venture vehicles funded partly by deferred purchase price mechanisms to be paid over time.

Each agreement established a global contribution value, aggregating the allocated values of the REOs as of specific cutoff dates. The allocated values, set forth in detailed data tapes, reflected agreed valuations.

Notably, the contracts distinguished between registered and unregistered REOs, with the latter potentially subject to market value adjustments. Deferred payments under the agreements were tied to a maturity date two years after the effective date, with provisions for further deferral and potential adjustment if certain REOs remained unregistered.

Disputes arose in late 2022 when maturity dates under the Challenger and Rex agreements approached. Sabadell argued that the deferred purchase price payments should be calculated based on the allocated values unless adjusted by fair market values determinations under the agreements.

Cerberus, however, contended that substantial portions of the deferred purchase price payments should not be paid, arguing for a significant write-down of amounts due, particularly concerning unregistered REOs. This disagreement centered on the proper interpretation of Clause 2.2.2(B)(ii), which governs fair market value adjustments for unregistered REOs.

The contracts' dual governance structure complicated the dispute. While the agreements were governed by Spanish law, the guarantees provided by Cerberus entities were governed by English law, granting the English courts jurisdiction. This dual framework became critical as the court was required to apply Spanish principles of contractual interpretation while also assessing enforceability under English procedural rules.

The Decision of the High Court

Judge Baker ruled in favor of Banco de Sabadell, concluding that the deferred purchase price provisions must be construed in a manner consistent with Sabadell's interpretation. The court found that Sabadell was entitled to approximately €358 million ($376 million), in outstanding payments, rejecting Cerberus's argument that deferred purchase price payments should be written down significantly or not paid at all.

The judgment hinged on the interpretation of Clause 2.2.2(B)(ii), which stipulates that payments for unregistered REOs are to be adjusted to reflect their fair market value if certain conditions are met.

The court accepted Sabadell's argument that the clause operates to adjust payments only to the extent of fair market value differences, rather than providing a mechanism for wholesale write-offs.

This interpretation aligned with the agreements' overarching commercial purpose, which was to deconsolidate Sabadell's REO portfolios at agreed allocated values, with adjustments limited to specific scenarios.

Under Spanish law principles, as codified in Articles 1281 and 1285 of the Spanish Civil Code, the court prioritized the parties' evident contractual intent over isolated textual ambiguities.

The evidence demonstrated that the parties intended the deferred purchase price payments to reflect allocated values, adjusted only where fair market value determinations were explicitly triggered. Judge Baker highlighted that the agreements' structure required coherence, rejecting Cerberus' construction as commercially illogical.

The judgment also addressed the calculation methodology for fair market value. Cerberus had argued that any outstanding deferred purchase price payments at maturity dates should automatically be reduced to fair market value for all REOs, regardless of whether fair market value determinations were explicitly triggered.

The court rejected this, noting that the agreements required active notice and procedural steps to trigger fair market value determinations. Cerberus' interpretation, the court concluded, would undermine the certainty of the agreements and contradict their expressed terms.

Additionally, the court scrutinized the implications of deferral provisions. Cerberus contended that deferrals beyond the maturity date effectively eliminated payment obligations for certain categories of REOs.

The court found this argument inconsistent with the agreements' language, which provided for deferrals as temporary mechanisms rather than permanent reductions. The distinction between deferral and adjustment was pivotal, ensuring that Sabadell's payment expectations were preserved absent explicit contractual mechanisms for reduction.

Ultimately, the court emphasized the role of good faith in interpreting and enforcing the agreements. Spanish commercial law requires that contracts be fulfilled in good faith, considering the entire agreement and avoiding arbitrary interpretations. The judgment underscored that Cerberus' construction lacked the necessary evidentiary and textual support to override this principle.

Takeaways

The decision provides substantive critical lessons for practitioners involved in drafting and litigating cross-border investment agreements. First, the case underscores the importance of precise and coherent drafting in deferred payment clauses. The High Court's interpretation hinged on reconciling individual provisions with the agreements' overall commercial objectives, highlighting the risks of ambiguous or conflicting terms.

Second, the judgment illustrates the challenges of operating within dual governance frameworks. While the agreements were governed by Spanish law, the guarantees fell under English law, requiring careful coordination of contractual obligations and enforcement mechanisms. Practitioners should ensure that governing law and jurisdiction clauses align with the commercial and procedural realities of the transaction.

Third, the case emphasizes the need for meticulous procedural compliance when triggering adjustment mechanisms such as fair market value determinations. The court's rejection of Cerberus' arguments underscores that adjustment provisions must be applied strictly according to their terms, leaving little room for expansive or unilateral interpretations.

Finally, the judgment highlights the role of good faith in cross-border commercial contracts. Spanish law's emphasis on good faith as a guiding principle aligns with broader international trends in commercial law, reinforcing the need for parties to act consistently with the agreements' evident purposes.

For future transactions, the ruling serves as a cautionary tale. Sophisticated parties must anticipate potential disputes and draft agreements that clearly address contingencies such as unregistered assets, deferred payments, and market value adjustments. The decision also reinforces the value of seeking judicial clarity when disputes arise, particularly where complex cross-border agreements are involved.

Undoubtedly, Banco de Sabadell v. Cerberus offers a crucial interpretation of deferred payment mechanisms in joint venture agreements, balancing contractual text with commercial realities. It provides a robust framework for understanding how English courts apply foreign law in complex cross-border disputes, ensuring that sophisticated commercial arrangements are honored according to their terms.

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