# GRUPO MEXICANO DE DESARROLLO, S.A. v. ALLIANCE BOND FUND, INC.: SUPREME COURT RESTRICTS CREDITOR'S RIGHT TO OBTAIN PRELIMINARY INJUNCTION FROM FEDERAL COURT TO PREVENT DISSIPATION OF ASSETS

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## INTRODUCTION

On June 17, 1999, the Supreme Court of the United States held that, in actions by private creditors for money judgments, federal courts do not have the authority to issue preliminary injunctions which prevent debtors from disposing of their assets, at least where those assets are not within the territorial jurisdiction of the District Court.[1] The Court concluded that such injunctions were beyond the scope of federal courts' historical equity jurisdiction, and represented a judicial usurpation of debtors' rights to control property until a judgment has been entered against them.

The *Grupo Mexicano* decision considerably weakens unsecured creditors' chances of recovering from insolvent debtors whose assets are not within the court's jurisdiction. While the decision does not diminish creditors' legal rights to payment, it limits their ability to prevent the debtor from using such assets as are available to satisfy certain favored creditors to the exclusion of others. Thus, while their claims against the debtor are being adjudicated, unsecured creditors may be forced to stand by as the debtor's assets are dissipated, rendering any judgment that they might obtain against the debtor uncollectible.

It should be noted that while this particular case involved a foreign debtor, the holding is based on the Federal Rules of Civil Procedure and thus applies equally to domestic as well as foreign debtors. However, the decision may have a greater impact on cases involving foreign debtors. Creditors of domestic debtors may have other options, such as the option to join with other creditors to initiate involuntary bankruptcy proceedings, and thus prevent dissipation of assets in that way.[2] However, many foreign jurisdictions provide for nothing more than liquidation in their insolvency laws; in such a case, a creditor might be faced with the difficult choice of forcing the debtor to liquidate in order to prevent disadvantageous treatment.

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1 Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 1999 WL 392980 (U.S.).

2 *See* 11 U.S.C. § 303.

## BACKGROUND

Grupo Mexicano de Desarrollo, S.A. (GMD) is a Mexican holding company that issued $250 million of 8.25% unsecured, guaranteed notes (Notes) in February 1994. The Notes were due in 2001 and ranked *pari passu* in priority of payment with all of GMD's other unsecured and unsubordinated debt. In issuing the Notes in the United States, GMD consented to personal jurisdiction in the Southern District of New York. Alliance Bond Fund, Inc. (Alliance) is an investment fund that purchased approximately $75 million dollars of the Notes.

Between 1990 and 1994, GMD was heavily involved in a toll road construction program sponsored by the Government of Mexico. Problems with the Mexican economy led to severe losses for those involved with the toll road project. By 1997, GMD's financial position had become critical, and neither GMD nor its subsidiaries made the August 1997 interest payment on the Notes.

Between August and December 1997, GMD attempted to negotiate a restructuring of its debts with its various creditors. GMD transferred its right to receive approximately $117 million in Mexican government notes (Toll Road Notes) to several of its Mexican creditors, including the Mexican government. Efforts to reach restructuring agreements with the holders of the Notes were unsuccessful.

On December 11, 1997, Alliance accelerated the principal of amount of the Notes it held and, on December 12, filed suit for the amount due in the United States District Court for the Southern District of New York. In their complaint, Alliance alleged that GMD was very nearly insolvent, if not already so; that the Toll Road Notes were GMD's only significant asset; that GMD was preferring its Mexican creditors by its agreement to transfer the Toll Road Notes to them; and that such a dissipation of GMD's assets would render any judgment obtained against GMD by Alliance ineffective. Alliance sought to collect $80.9 million on the Notes and also requested a preliminary injunction restraining GMD from transferring its assets to its Mexican creditors as planned. That day, the District Court entered a temporary restraining order preventing GMD from transferring the Toll Road Notes.

On December 23, 1997, the District Court preliminarily enjoined GMD from transferring any of its interests in the Toll Road Notes, and ordered Alliance to post a $50,000 bond. GMD appealed the propriety of this preliminary injunction to the Second Circuit, which affirmed, and then to the Supreme Court, which reversed. While those appeals were pending, the District Court granted summary judgment to Alliance on all of its claims, and ordered GMD to pay Alliance approximately $82 million. The District Court also converted the preliminary injunction into a permanent injunction.

## ANALYSIS

After disposing of Alliance's arguments concerning mootness, the Court turned to an analysis of the scope of the equity powers of the federal courts.[3] Since the federal courts' authority to decide cases in equity was conferred in 1789, the Court looked to the practices of the English Court of Chancery at that time in order to determine the extent of the equitable powers granted to the federal courts. Thus, the permissibility of the injunction in question hinged on its historical availability.

After noting that such an injunction had never been affirmatively recognized in federal courts prior to the Second Circuit's affirmation in the present case, the Court rejected the argument that this injunction was analogous to an equitable action known as a "creditor's bill," a remedy that was used to permit a judgment creditor to discover the debtor's assets and to set aside fraudulent conveyances.[4] The majority found that such a remedy was historically available only to creditors who had already obtained a judgment against the debtor. In the Court's view, the requirement of a judgment furthered the "substantive rule that a general creditor (one without a judgment) had no cognizable interest, either at law or in equity, in the property of his debtor, and therefore could not interfere with the debtor's use of that property."[5] The Court made it clear that they fear the mischief that could arise from false claimants who are too easily permitted to obtain injunctions, envisioning a regime in which transfers of property might be restricted merely by making unsubstantiated allegations of an intention to escape debts.

The Court also rejected attempts to analogize this case to two past cases in which the issuance of preliminary injunctive relief had been upheld, *Deckert v. Independent Shares Corp.* and *United States v. First National City Bank*.[6] *Deckert* involved claims for recission of contracts and restitution of consideration paid under the Securities Act of 1933, and plaintiffs requested a preliminary injunction preventing the defendant corporation from transferring assets during the pendency of the suit. The Court emphasizes the fact that the remedies sought, recission and restitution, were equitable in nature, and distinguished the case from the current situation thus:

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3 Alliance argued that the District Court's conversion of the preliminary injunction into a permanent injunction rendered this case moot, because the preliminary injunction merged into the permanent injunction. According to this argument, GMD, having lost on the merits, would not be entitled to relief even if the preliminary injunction was wrongful. The Court, though, rejected this argument and held that GMD's action was not moot because it could still seek damages for wrongful injunction against the injunction bond that had been posted by Alliance.

4 *Grupo Mexicano*, 1999 WL 392980 at *7.

5 *Id*. at *7.

6 *Id*. at *9-*10.

"The preliminary relief available in suit seeking equitable relief has nothing to do with the preliminary relief available in a creditor's bill seeking equitable assistance in the collection of a legal debt."[7]

*First National* involved a suit by the United States to enforce a tax assessment and a tax lien. The Court distinguished this case from the matter at hand on several grounds, noting that the preliminary injunction in the First *National* case had a specific basis in the tax statutes, and that federal equity powers will be interpreted more expansively on behalf of public interests than private ones.[8]

Finally, the Court noted that English courts did not begin providing injunctions of this type until 1975.[9] According to the Court's logic, the fact that such injunctions were recognized as new in 1975 is dispositive in that it demonstrates that such injunctions were not available in 1789. The Court declined to expand this historical equity jurisdiction by permitting injunctions which obviate the need to obtain a judgment, a need which it views as a "fundamental protection in debtor-creditor law."[10]

Four justices dissented. First, they noted that the fact that equity courts have not traditionally issued preliminary injunctions of this type does not necessarily indicate that it was beyond their power to do so; such injunctions may have been thought unnecessary in the age of relatively immobile wealth.[11] Also, the dissent conceived of equity as being flexible by nature, a necessary attribute if it is to continue in its function of ensuring that the application of the law does not result in substantive injustice. They argued that, in the instant case, Alliance's legal remedies alone would have been inadequate, because the court, working as expeditiously as possible, still took approximately four months to enter a final judgment on the merits.[12]

In response to the Court's fear of meritless injunctions restricting debtors' property rights, the dissent pointed to the safeguards inherent in the traditional standards for preliminary injunctions. Generally, in order to obtain preliminary injunctive relief, plaintiffs must demonstrate a likelihood of success on the merits and irreparable injury in the absence of

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7 *Id*. at *10.

8 *Id*. at *10.

9 See Mareva Compania Naveria S.A. v. International Bulkcarriers S.A., 2 Lloyd's Rep. 509 (Court of Appeal 1975).

10 *Grupo Mexicano*, 1999 WL 392980 at *12

11 *Id*. at *16.

12 *Id*. at *17.

an injunction. It is unlikely that plaintiffs with dubious claims would be able to meet this burden.[13]

The dissent viewed the present case as a paradigm of the type of case in which preliminary injunctive relief would normally be granted under these traditional standards. GMD's debt to Alliance was undisputed. GMD had made concrete agreements to dispose of its assets in such a way as to leave little or nothing for Alliance. Thus, Alliance was likely to succeed on the merits (which it in fact did, less than four months after the initiation of the action), and it would have been irreparably damaged without the protection of the injunction, in that its judgment would almost certainly have been uncollectible after all of GMD's assets had been dissipated. The dissent noted that allowing GMD to use the delay inherent in the judicial process in order to dissipate its assets appears to be inequitable, and asserts that it is perfectly within the scope of the federal courts equity jurisdiction to remedy such an injustice.[14]

## SUMMARY

The *Grupo Mexicano* decision represents a clear limitation of unsecured creditors' rights. By foreclosing on the possibility of obtaining a preliminary injunction from a federal court, the Court has made it more difficult for them to actually recover from insolvent debtors and increased the risk that federal judgments against debtors will be uncollectible. Once again, it should be noted that this holding is not limited to cases involving non-U.S. debtors; preliminary injunctions against dissipation of assets outside the district court's territorial jurisdiction will no longer be available in federal courts at all. It should also be noted, however, that, in cases where the assets themselves are in the court's jurisdiction, federal courts can still employ in appropriate circumstances provisional remedies, such as attachment, to prevent assets from fleeing that jurisdiction. Additionally, an unsecured creditor may join with others to put the company in bankruptcy involuntarily. Finally, state courts may provide creditors with different remedies.

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If you have any questions or comments concerning the *Grupo Mexicano* decision, please do not hesitate to contact Thomas Rice (at 212-455-3040) or Mark Thompson (at 212-455-7355).

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13 *Id.* at *17.

14 *Id.* at *18.