GARRIGUES

Newsletter

Restructuring and Insolvency Work

February 2016

Contents

I. New legislation

1. *Approval of a standard application form for the procedure to reach out-of-court payment agreements. Order JUS/2831/2015 of December 17, 2015.*

On December 29, 2015, Order JUS/2831/2015 of the Ministry of Justice of December 17, 2015, was published in the Official State Gazette. This Order approves a standard form for applications for the procedure to reach out-of-court payment agreements, thereby implementing the legislative provision laid down in article 232.2 of the Spanish Insolvency Law.

The form must be completed, first of all, with the particulars of the applicant, whether an individual or legal entity, as well as a description of the applicant's personal and family circumstances, or status as an employee or independent professional, as appropriate. The form then contains a section on satisfaction of the requirements to initiate this procedure, as well as a section in which the applicant must list the assets and rights he owns. Lastly, the form asks the applicant to provide a list of creditors, enabling the extent of his liabilities to be ascertained.

As well as incorporating the abovementioned form as a schedule, the Order contains the following requirements:

(i) Applications from non-traders must be sent to a notary for their place of residence. Whereas traders and entities which may be registered at the Commercial Registry may send their applications: (i) to the commercial registrar for their place of residence; or (ii) to the appropriate Official Chamber of Commerce, Industry, Services and Shipping.

(ii) Applications may be submitted electronically.

(iii) Applications to initiate the procedure, as well as any notarial or registration expenses resulting from the appointment of the insolvency mediator, will not entail any costs for individuals who are not traders.

The Order came into force on January 18, 2016.

II. Selected court cases and major settlements

1. *"Seda" case: judgment dated December 21, 2015 rendered by Chamber One of the Supreme Court*

In the insolvency proceeding on Seda Solubles, S.L. ("Seda"), three financial institutions in a banking syndicate brought an ancillary claim challenging the list of creditors and seeking: (i) recognition that the petitioning creditors in the mandatory insolvency proceeding held general preferred status under article 91.7 of the Insolvency Law; and (ii) the allocation of 50% of such general preferred status to the full amount of the pre-insolvency order claims held by the financial institutions, with subordinated claims excluded from the calculation base.

Palencia Court of First Instance No 1 upheld the ancillary action in part, finding that the general preferred status laid down in article 91.7 of the Insolvency Law should be calculated by reference to the sum of the claims held by the petitioning creditor in the insolvency proceeding which are not subordinated claims. The Court held, however, that such preferred status should

be recognized only in respect of the claims held by the petitioning creditor owed the highest debt and should be distributed between the three petitioning creditors according to the amount of their respective claims, in accordance with the "proportionate internal distribution principle".

The petitioning creditors appealed against this last point to the Provincial Appellate Court, which confirmed the approach taken by the Court of First Instance.

The point was further appealed in cassation. The Supreme Court dismissed the appeal, holding that: (i) the purpose of the rule is to grant general preferred status to only one petitioning creditor in the insolvency as compensation for the exposure to costs and damage or loss he assumes when petitioning for mandatory insolvency; (ii) the recognition of full preferred status in favor of a number of creditors who petitioned jointly for the insolvency would render the principle of *pars conditio creditorum* devoid of substance; and (iii) the fact that the claims of the three petitioning creditors have the same origin (the syndicated financing agreement) is irrelevant for the purpose of granting the general preferred status defined in article 91.7 of the Insolvency Law and making the distribution between the petitioning creditors in accordance with the "proportionate internal distribution principle".

2. *Judgments dated November 11, 2015 and January 15, 2016 rendered by Panel 28 of Madrid Provincial Appellate Court*

In the insolvency proceedings on Inversora de Autopistas de Levante, S.L. and Autopista Madrid Levante C.E., S.A., the claims of one of the financial institutions were classified as subordinated, because this financial institution was considered to be a specially related person in the insolvency proceeding on account of having been the sole shareholder of a company which, in turn, was director at the insolvent debtors in the two years preceding the insolvency order.

Although at first instance the Court confirmed the subordinated nature of the bank's claims, Madrid Provincial Appellate Court upheld both appeals by the financial institution and ordered that the classification of its claims be changed from subordinated to specially preferred. Specifically, the Provincial Appellate Court based its decision on the following grounds: (i) subordination applies to claims held by *de facto* and *de jure* directors of the insolvent party and to persons who held that status in the two years preceding the insolvency order; it does not apply to the shareholders of those directors; (ii) the theory of lifting the corporate veil cannot be applied in order to subordinate the claims held by the sole shareholder of the company that was formerly a director, because the existence of fraud in the establishment of that director company had been ruled out; (iii) the mere fact that the bank and the company that was formerly a director are part of a corporate group is not the decisive factor for subordination purposes, since the true position as regards legal personality must be respected; (iv) the dispute cannot be resolved by finding that the bank was a *de facto* director of the insolvent parties, because this argument was never put forward by the insolvency manager and, therefore, falls outside the scope of the proceedings; and (v) the fact that the subsidiary of the bank was a sole-shareholder company is not conclusive either; this fact does not, in itself, erase the boundaries of the legal personality of the companies involved.

III. Group of cases: clawback actions

1. *Judgment dated October 5, 2015 rendered by Madrid Commercial Court No 9 ("Estate of Gonzalo Pascual" case)*

The Court granted the insolvency manager's application seeking clawback of a mortgage taken out by an insolvent individual on his family home on the ground that it was detrimental to the assets available to creditors. Offering up the home as collateral to prevent immediate enforcement action against the assets of the insolvent party's company was unlikely to be able to compensate for the sacrifice to the individual's assets. The Court also dismissed the insolvency manager's application to render invalid the mortgage foreclosure proceeding which led to the property being awarded, since this was not an act carried out by the debtor nor did it occur before the insolvency order. Nonetheless, the Court did find that the foreclosure was unenforceable due to the clawback of the creation of the mortgage. In insolvency proceedings on individuals subject to a community property matrimonial arrangement, there is no need to make an express claim against the spouse on account of her being co-owner of the property; in the present case, it is inconceivable that the spouse would be unaware of the ancillary claim resolved by the judgment.

2. *Judgment dated October 16, 2015 rendered by Alicante Commercial Court No 1 ("Colefruse" case)*

The Court upheld a clawback action concerning an agreement to refinance a group of companies. In particular, the Court based its decision on the following arguments: (i) the refinancing agreement did not meet the requirements set out in the Insolvency Law in order to be exempt from clawback, as there was no report by an independent expert appointed by the Commercial Registry; (ii) the agreement in question did not actually significantly increase the loan, or actually extend the maturity date, or actually convert short-term obligations into long-term obligations, with the result that the debt was not actually refinanced; (iii) the provision of all the items of security were acts of disposition for no consideration, since there was no correlative advantage, either of a direct or indirect nature, for the now-insolvent subsidiaries of the group; (iv) the unfortunate financial and cash-flow situation of the insolvent entities prior to the refinancing agreement indicates the existence of creditor fraud in the provision of the security, with the result that it is not necessary to review the exceptions set out in Royal Decree Law 5/2005 and article 10 of the Mortgage Market Law. In upholding the action, the Court found that the new security provided was unenforceable; ordered repayment of the expenses associated with providing the security; and ordered that the status of the creditors be reclassified as ordinary rather than specially preferred.

3. *Judgment dated November 3, 2015 rendered by Chamber One of the Supreme Court*

The Supreme Court confirmed the option of reporting creditor fraud by bringing various other types of action, in addition to clawback action, seeking to secure a declaration that the legal act is unenforceable, based on the satisfaction of various requirements and on the nature of the fraud. The Court held that different types of action could be brought in cases, for example, of an absolute sham, where the reason for the sham is creditor fraud, or where contracts are concluded in which the parties acquire real obligations but for fraudulent purposes. Accordingly, the Court held that it is allowable for these actions to be joined with clawback actions, the usual practice being to bring action for nullity as the main claim and clawback action, as a secondary claim, without the insolvency proceeding on the person against whom such actions are directed posing any obstacle.

4. *Judgment dated December 15, 2015 rendered by Bilbao Commercial Court No 1*

The Court recognized that a creditor had *locus standi* to bring a clawback action even though their claim had arisen after the act they sought to be clawed back. The Court also upheld an action to claw back the insolvent party's decision to offset claims owed by its shareholder against a number of invoices issued by the shareholder in its favor for which there were no supporting documents. The clawback was justified since the offset involved an act of disposition for no consideration given the absence of supporting documents, giving rise to the irrefutable presumption of detriment to the insolvent party's assets.

5. *Judgment dated December 22, 2015 rendered by Madrid Commercial Court No 7 ("Trapsayates" case)*

The Court dismissed action for clawback against an act performed by the insolvent party involving the provision of collateral to a financial institution to secure a loan granted by the bank to a subsidiary. The Court held that detriment to assets exists where the questioned act contravenes the principle of maximizing the value of the assets available to creditors or where it places one creditor in a more advantageous position with respect to the other creditors, thereby infringing the principle of *pars conditio creditorum*. The Court concluded that the provision of collateral was neither for no consideration nor detrimental since its aim was to restructure the subsidiary financially – which was one of the parent company's main sources of income – because the provision of collateral would enable the subsidiary to secure sufficient financing and avoid it having to make a claim against the insolvent party for repayment of the debt owed to it.

IV. Insolvency round-up

1. *Unenforceable nature of decisions validating refinancing agreements: decision dated February 19, 2014 rendered by Barcelona Provincial Appellate Court*

The decision validating the debtor's refinancing agreement determined that a debt stay was binding on the dissenting entities, stating that the imposed stay implied that the discount facilities would be retained on the covenanted terms but with an extended period for payment. The financial institution refused to allow the debtor to make further drawdowns and as a result of this refusal the debtor applied for an enforcement order, which was issued by the Court. The Provincial Appellate Court upheld the financial institution's objection to the enforcement on the ground that the decision validating a refinancing agreement is not an enforceable instrument, arguing that the list of enforceable instruments is a finite list and does not include refinancing agreements. Despite the breach by the financial institution, it was not possible to impose performance of the contents of the order directly, since the creditor's obligation derives from the contract to which the validation decision relates, not the decision itself. Accordingly, any claim for liability in respect of a breach must be made under the ordinary rules.

2. *Transfer of productive units and subrogation to debts owed to the social security authorities: judgment dated February 16, 2015 rendered by Zaragoza Provincial Appellate Court*

The Court overturned the judgment under appeal which provided for the transfer of the company as a productive unit subject to express exemption for it from subrogation to any debts owed to the social security authorities before the disposal. The Court held that the option

of releasing the transferee from social security obligations is contemplated not in the insolvency legislation but in special legislation. Accordingly, a ruling on this element fell outside the powers of the court hearing the insolvency proceeding, which could only issue such a ruling as a pre-trial ruling unable to produce any effects outside the insolvency proceeding.

3. *Assessment of an insolvency as fortuitous: judgment dated June 4, 2015 rendered by Valencia Provincial Appellate Court*

On appeal, the Provincial Appellate Court confirmed the assessment of the insolvency as fortuitous on the ground that the intentional element of fraud and the complicity of a parent company cannot be based on the mere fact that the parent company was found to be a specially related person. The list of the specially related persons in article 93 of the Insolvency Law is for the sole purpose of classifying claims and is transposable only to the presumption of detriment set out in article 71.3 of the Insolvency Law. Therefore, since no fraud was found to exist, the Court confirmed the judgment handed down at first instance in its entirety.

4. *Dismissal of a declinatory exception filed due to the existence of a contract clause of express submission ("Marme" case): decision dated June 26, 2015 rendered by Madrid Commercial Court No 9*

The insolvent party applied for the termination of a number of financial swap agreements in the interests of the insolvency proceeding. The financial institution objected and lodged a declinatory exception on the ground of lack of international jurisdiction due to the existence of a clause providing for express submission to foreign courts. The Court dismissed the declinatory exception, basing its decision on the unenforceability of the contractual submission clause after an insolvency order has been handed down, pursuant to article 4 of Regulation No 1346/2000 which provides, as a general rule, that the law applicable to insolvency proceedings and their effects is that of the Member State within the territory of which such proceedings are opened (State of the opening of proceedings). Consequently, the applicable law in this case was Spanish law, particularly the rules set out in the Insolvency Law on the effects of the insolvency order on contracts, which confer jurisdiction to hear matters relating to such contracts on the insolvency court.

5. *Service of an insolvency order on a spouse subject to a community property matrimonial arrangement: decision of the Directorate-General of Registers and the Notarial Profession dated October 23, 2015*

The Directorate-General of Registers and the Notarial Profession confirmed that it was necessary to serve the insolvency order on the spouse of the insolvent party, subject to a community property matrimonial arrangement, as one of the requirements of the right to effective judicial protection. The decision states that since marital property forms part of the assets available to creditors, the right of the debtor's spouse to apply for dissolution of the marital arrangement can only be effective if the insolvent party's spouse is aware of the insolvency order. Consequently, it is not possible to enter a provisional noting of the insolvency order in respect of marital property at the Property Registry where there is no record of the insolvency order having been served on the insolvent party's spouse.

6. Validation of a refinancing agreement reached with a single shareholder ("Quabit" case): decision dated November 11, 2015 rendered by Madrid Commercial Court No 5

The Court validated a refinancing agreement reached with a single creditor (SAREB). The application for validation was made without requiring the effects of the agreement to be binding on dissenting creditors. The Court found that all of the requirements necessary to validate a refinancing agreement had been met: i) viability plan; ii) auditor's certificate on the sufficiency of the majorities signing the agreement; and iii) formalization in a public deed.

7. Maintenance of contracts linked to an offer to purchase a productive unit ("Juguetería Poli" case): decision dated November 16, 2015 rendered by Madrid Provincial Appellate Court

The appellants challenged the decision approving the liquidation plan, arguing that it was not possible to transfer lease agreements as part of the sale of the productive unit, as provided for in the liquidation plan, without the lessors' consent. The Court pointed out that different treatment should be given to transfers of contracts which take place in an independent or isolated fashion, and transfers which occur within the framework of the transfer of a productive unit in an insolvency proceeding. The Court also argued that the requirement to obtain the individual consent of every lessor would, in practice, frustrate the disposal of the company as a whole. For those reasons, it concluded that article 191.2 *ter* of the Insolvency Law enshrined a general rule enabling the insolvency court to order the maintenance of contracts linked to an offer to purchase a productive unit with the automatic subrogation of the acquirer to these contracts, an interpretation which was confirmed when the new article 146 *bis* of the Insolvency Law came into force.

8. Removal of encumbrances pre-dating the insolvency proceeding established in favor of pre-petition claims: decision dated November 17, 2015 rendered by León Court of First Instance No 8 (Commercial)

The Court held that not all notings or entries at registries may be removed once the property no longer forms part of the estate; only those which were established in favor of credit rights may be removed (article 149.5 of the Insolvency Law). In the present case, some encumbrances on transferred properties, which the insolvency manager applied to have removed, had not been established to protect a credit right but had instead been created for other purposes. The Court therefore permitted the removal of the attachments and the noting of the insolvency proceeding, but not the removal of a condition subsequent or the other encumbrances (namely, obligations imposed on the parties awarded the properties in the administrative award contracts or those deriving from the existing administrative lease).

9. Put options and insolvency proceedings ("Afinsa" case): judgment dated November 19, 2015 rendered by Chamber One of the Supreme Court

Assessment of a collection right arising in respect of the right to perform a sale transaction covenanted in favor of a creditor acquiring stamps as a pre-insolvency order claim. The Supreme Court held that the put option conferred on the acquirer of the stamps the power to sell the lots for a specific price, after an agreed term, subject to the only requirement that he express his intention to exercise this option. The option-holder's claim would be regarded as an unsecured claim if the term under the contract has already ended and the repurchase and contingent obligation could be enforced within the period until the end of the term.

10. Approval of a proposed arrangement ("Grupo San Cayetano" case): judgment dated November 23, 2015 rendered by Valladolid Commercial Court No 1

The insolvent party submitted a proposal for a creditors' arrangement with two alternatives for its ordinary creditors: (i) a 65% write-off with a 10-year stay; or (ii) a 90% write-off with a two-year stay, which would apply if no election was made. For secured creditors, the proposal provided for a 45% write-off and a 10-year stay, but included an early payment clause in the event of the successful outcome of negotiations with the financial institutions. The proposal also contained the following provisions: (i) postponement of the enforceability of the arrangement until the judgment approving it becomes final; (ii) requirement of approval by a double majority of ordinary creditors (65%) and secured creditors (75%); (iii) inclusion of the option of making advance prorated payments to ordinary and subordinated creditors without this entailing any breach whatsoever; and (iv) any one-off failure to make an annual payment would not be regarded as a breach of the arrangement provided that one month's notice thereof is given and the missing amount is paid together with the following annual payment. The Court held that the arrangement did not contravene the rules laid down in the Insolvency Law and, therefore, approved it. It made clear, however, that the arrangement would not bind creditors holding secured commercial claims since the required majority for that class of creditors had not been met.

11. Separate foreclosure by a mortgagee in the insolvency proceeding on a non-debtor mortgagor: decision dated December 9, 2015 rendered by Barcelona Commercial Court No 10

The State Tax Agency (*Agencia Estatal de la Administración Tributaria* or "AEAT") applied for court authorization to initiate, under article 56 of the Insolvency Law, a separate foreclosure proceeding in respect of a property mortgaged to it by the insolvent party to secure a third-party debt. The Court held that the halting of enforcement proceedings envisaged in article 56 of the Insolvency Law only applied in respect of creditors of the insolvent party. Since AEAT did not appear on the list of creditors of the insolvent party, the statutory provisions in respect of secured creditors did not apply to it. The Court therefore recognized that AEAT had a separate right of enforcement over the insolvent party's property which was mortgaged to it.

12. Liability of a director of a subsidiary who followed the instructions issued by the management of the corporate group ("Alphaspray" case): judgment dated December 11, 2015 rendered by Chamber One of the Supreme Court

The question before the Court was whether the acts of the director of the insolvent company, by which he diverted most of the company's customer base to another group company, could constitute a ground for a claim for liability against the insolvent party's directors. The Court held that the interests of the group did not, *per se*, justify the harm caused to the subsidiary, and that in the event of conflict between the interests of the group and those of the company, it was necessary to strike a reasonable balance between the advantages conferred or the assistance provided in both directions and decide whether or not there was an adverse outcome for the subsidiary. Accordingly, since there were no compensatory advantages for the subsidiary, the director had infringed his duty of loyalty and had not only caused clear financial harm to the company at which he held a directorship, but had also endangered its viability and solvency.

13. *Lack of locus standi to bring action seeking a declaration of breach of an arrangement due to nonpayment of post-insolvency order claims: decision dated December 22, 2015 rendered by Palma de Mallorca Commercial Court No 1*

The insolvency manager applied for a declaration of breach of the arrangement due to the nonpayment of its fees. The insolvent party contested the claim on the ground that the insolvency management had no *locus standi* to bring action seeking a declaration of breach of the arrangement, since its claims were not affected by the content of that arrangement. In line with the insolvent party's reasoning, the Court held that post-insolvency order claims were not affected by the arrangement and, therefore, could not confer *locus standi* to bring action for breach thereof under article 140 of the Insolvency Law. The claim brought by the insolvency manager was dismissed on the ground of lack of *locus standi*, without prejudice to the insolvency manager being able to use the remedy provided in article 142.2 of the Insolvency Law to satisfy its claims.

14. *Requirements for complicity in the assessment context: judgment dated January 27, 2016 rendered by Chamber One of the Supreme Court*

The director of the insolvent party had stripped the latter of its assets to the benefit of a third-party company, the director of which was his partner, causing production outputs which were not invoiced. The insolvency was assessed as fault-based due to accounting irregularities and dealings in assets with a view to defrauding creditors, resulting in the director of the third company being found guilty of complicity. There are two requirements for complicity in the assessment context: (i) material assistance in the performance of the acts forming the basis of the assessment that the insolvency was fault-based; and (ii) the existence of willful misconduct or gross negligence in the provision of such assistance. The Court held that the assistance provided by the accomplice need not necessarily pre-date the insolvency order, since article 166 of the Insolvency Law does not lay down any time limit. In order to make a finding of willful misconduct or gross negligence on the part of an accomplice, it is sufficient for there to be an awareness of detriment to the creditors ("*scientia fraudis*"). No other proof of this purposive element or proof of an express intention to cause harm to the creditors are required.

V. Newsflash

1. *Drop in the number of insolvency proceedings*

According to recent figures from the Spanish National Statistics Institute, the number of insolvency proceedings dropped significantly in the third quarter of 2015.

Specifically, in the third quarter of 2015 the number of insolvent debtors stood at 1,143, down by 21.3% compared to the same period in 2014. By type of proceeding, ordinary insolvency proceedings fell by 29.9% whilst abbreviated proceedings fell by 19.3%. Following the data for this last quarter of 2015, the number of insolvency proceedings has fallen for eight quarters in a row.

2. *Pescanova looks to increase its capital stock by up to €1,000 million*

After the decision to be re-listed on the stock exchange, the shareholders of Nueva Pescanova, mostly financial institutions owning 62.3% of the company (including Banco Popular, Abanca,

Sabadell, BBVA, Bankia, Caixabank and UBI), are considering a capital increase by swapping debt for equity in an amount of between €400 and €1,000 million, enabling them to meet the equity needs of the new entity.

3. Approval of the Banco Madrid liquidation plan

At the end of December 2015, Madrid Commercial Court No 1 approved the liquidation plan of Banco Madrid submitted by the company's insolvency managers.

To deal with debts close to €500 million, the plan contains a number of measures including debt write-offs for creditors as well as the sale of properties owned by Banco Madrid appraised at a sum in the region of €323 million.

VI. Garrigues archives

1. Publications

- ***"El convenio concursal"*** (Insolvency Arrangements), Gutiérrez Gilsanz, *La Ley*, December 2015.
- ***"El nuevo régimen de responsabilidad de los administradores de empresas en crisis"*** (The new rules on directors' liability at distressed companies), Pardo Pardo, Bosch, 2015.

2. Garrigues Blog

- ***"Qué saber acerca de la compra de activos y empresas en concurso de acreedores"*** (What you need to know about buying assets and companies in Spanish insolvency proceedings)
- ***"La subasta y las deudas de las empresas en concurso de acreedores"*** (Insolvency auctions and the debts of businesses)

3. Awards

- **European Law Firm of the Year**

  Garrigues was named European Law Firm of the Year by the international legal publication *Legal Week* at the British Legal Awards 2015, held in London.

  One of the most prestigious awards in the UK legal services industry, the British Legal Awards recognize leading firms, teams and professionals in the market that have excelled due to their achievements in 2015. This is the second time Garrigues has received this accolade (after previously winning in 2011).

4. Legislative assistance

In December 2015, Adrian Thery Martí, a partner in the Restructuring and Insolvency Department, was appointed as a member of the expert group established to assist the European Commission in drafting a potential legislative proposal containing minimum standards for a harmonized restructuring and insolvency law in the European Union.

More information:

Antonio Fernández
Partner in charge of Restructuring and Insolvency Work
antonio.fernandez.rodriguez@garrigues.com
T +34 91 514 52 00

Borja García-Alamán
Partner
borja.garcia-alaman@garrigues.com
T +34 91 514 52 00

Adrián Thery
Partner
adrian.thery@garrigues.com
T +34 91 514 52 00

Juan Verdugo
Partner
juan.verdugo.garcia@garrigues.com
T +34 91 514 52 00

Hermosilla, 3 - 28001 Madrid (Spain)
T +34 91 514 52 00 - **F** +34 91 399 24 08