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RESTRUCTURING
& INSOLVENCY

DECEMBER 2017

INSOLVENCY AND PUBLIC SECTOR

SUMMARY

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ASSET CLAWBACK ACTIONS AND INTERNATIONAL INSOLVENCY PROCEEDINGS: TWO JUDGMENTS ON THE EFFECTS OF THE "VETO CLAUSE" UNDER THE INSOLVENCY REGULATION

Article 13 of Regulation (EC) No 1346/2000 on insolvency proceedings recently came under the spotlight in two judgments, one delivered by the CJEU (judgment of June 8, 2017, *Vinyls Italia* SpA, C-54/16) and the other by Palma de Mallorca Provincial Appellate Court (judgment of October 17, 2017, *Grupo Orizonia*). That article, which concerns detrimental acts or dealings performed by a company before the opening of insolvency proceedings, appears in virtually identical terms in Regulation (EU) 2015/848, which, since June 26, 2017, sets out the new rules on cross-border insolvency proceedings. These two judgments, particularly *Vinyls*, demonstrate the importance of European insolvency law.

Under European insolvency law, asset clawback actions targeting detrimental acts performed by a company are, in principle, governed by the law of the State where the insolvency proceedings are conducted. However, there also exists a "veto rule" under which national law will not apply if the person who benefited from the detrimental act provides proof that (i) the act is subject to the law of another Member State, and (ii) that law does not allow any means of challenging the act in the case in point. Accordingly, if it can be proven that it is not possible under the law (of another Member State) chosen by the parties to challenge the act, that act cannot be clawed back under the national law.

The CJEU had previously considered this veto on the application of national insolvency law in other judgments. The *Vinyls* judgment, however, is particularly interesting because the subject of the challenge — a payment made prior to the insolvency order — had connections only with Italy (Italian parties, construction of a ship in Italy, payment made in Italy, etc.). In that case, the parties had chosen English law as the law governing the contract. That choice of a law with no ostensible connection with the parties or with the obligations under the contract was the subject of a detailed examination by the CJEU in its judgment, since the ability to elect a foreign law to govern a purely domestic contract is typically criticized by proponents of the view that this enables the application of national insolvency law to be circumvented.

The CJEU's reply is that it is entirely open to the parties to make that choice of law and, in the event of the subsequent insolvency of one of the parties, invoke the "veto rule" and avoid the application of national insolvency law. The only exception is where the choice of law is fraudulent or abusive (which is a matter for the court conducting the insolvency proceedings to ascertain), in which case it will not be possible to veto the application of national law.

That was the very approach taken by the Spanish court in *Grupo Orizonia*: to veto the application of Spanish insolvency law after ascertaining that another law (English law) governed the payments made by a Spanish company to its legal and financial advisers prior to the insolvency proceedings. Palma de Mallorca Provincial Appellate Court held that since those payments were lawful under English law, Spanish insolvency law could not be applied. The court also drew attention to a fundamental issue raised by the CJEU in the *Vinyls* judgment: the person relying on the veto on the application of national insolvency law is not required to prove, in the abstract and in all cases, that the act at issue is not open to challenge under the foreign law, only that — in the specific case in point and in the light of the individual circumstances — the foreign law chosen by the parties does not allow any means of challenging the act at issue.

The choice of a law of another Member State in purely domestic contracts is commonplace in some sectors and is an option permitted under EU law. The only limit is that this choice should not infringe the mandatory provisions of the State with which the contract has all of its connections. Precisely because it is standard practice, it is not easy to identify the cases in which the choice of a law of another Member State is not simply the result of electing the most appropriate legislation to govern the contract, but rather an attempt to control the enforceability of national insolvency legislation in the event of the subsequent insolvency of one of the parties.


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2 New legislation

The new Public Sector Contracts Law 9/2017, which transposes Directives 2014/23/EU and 2014/24/EU of the European Parliament and of the Council of February 26, 2014, was published in the Official State Gazette on November 9, 2017.

The most notable elements of the new Law from an insolvency standpoint are as follows:

TEMPORARY BUSINESS ASSOCIATION ("UTE")

i. Public contracts may not be awarded to UTEs if any of their component companies are barred from entering into contracts (because they are subject to an insolvency order or have been disqualified following an assessment judgment, for example).

ii. If an insolvency order is handed down against any of the UTE's companies after the public contract has been awarded, performance of the contract with the remaining company or companies will continue even if the liquidation phase of the insolvency proceedings has been opened, provided that the other members of the UTE meet the stipulated requirements as to creditworthiness and classification.

PROHIBITION ON ENTERING INTO PUBLIC SECTOR CONTRACTS

i. Once again, the prohibition on entering into public sector contracts applies to companies that: (i) have petitioned for voluntary insolvency; (ii) have been found to be insolvent in any proceedings; (iii) have had an insolvency order made against them (unless an arrangement is in force); (iv) are subject to court control; or (v) have been disqualified following an assessment judgment.

ii. The new Law also retains the rule that the ban on entering into contracts is to be assessed directly by the contracting authorities and will remain in force for as long as the grounds justifying the ban exist.

CLASSIFICATION OF CLAIMS ARISING UNDER CONTRACTS WITH PUBLIC AUTHORITIES FOR THE PURPOSE OF INSOLVENCY PROCEEDINGS

Claims arising from statutory obligations or administrative acts will be classified as generally preferred claims with respect to up to 50% of their aggregate amount. If those claims are secured in accordance with the requirements set out in the Insolvency Law, they will be classified as secured claims.

SPECIAL CONTRACT PROCEDURES

Supply and service contracts may be awarded in a negotiated procedure without advertising (that is, without prior publication of a contract procurement notice) with respect to: (i) services or supplies agreed on particularly advantageous terms with a provider that is definitively winding up its business; (ii) services or supplies agreed with the insolvency manager or under a court-approved agreement.

GROUNDS FOR TERMINATION OF CONTRACTS WITH PUBLIC AUTHORITIES

i. The new Law retains the making of an insolvency order or a declaration of insolvency in any other proceedings as a ground for termination.

ii. It clarifies public authorities' power to terminate the contract if the contractor goes into insolvency. Thus, even if the liquidation phase of the insolvency proceedings has been opened, public authorities may voluntarily continue with the contract if there are public interest reasons, provided that the contractor provides additional sufficient additional guarantees to ensure the contract's performance.

ASSIGNMENT OF CONTRACTS WITH PUBLIC AUTHORITIES

In order for contracts to be assigned, the requirements set out in the tender specifications document must be met. One of those requirements is that at least 20% of the contract amount must have been performed or, in the case of a works concession contract or service concession contract, the concession activity must have been conducted for at least one fifth of the contract term. Those requirements do not apply if the contractor is in insolvency, even where the liquidation phase has been opened, or if the contractor has filed an application under Article 5 bis of the Insolvency Law ("pre-insolvency proceedings").

Final provision sixteen provides that the new Law will enter into force four (4) months after its publication in the Official State Gazette, that is, on March 9, 2018. However, there are a number of exceptions with respect to certain provisions, none of which concern the matters covered here.

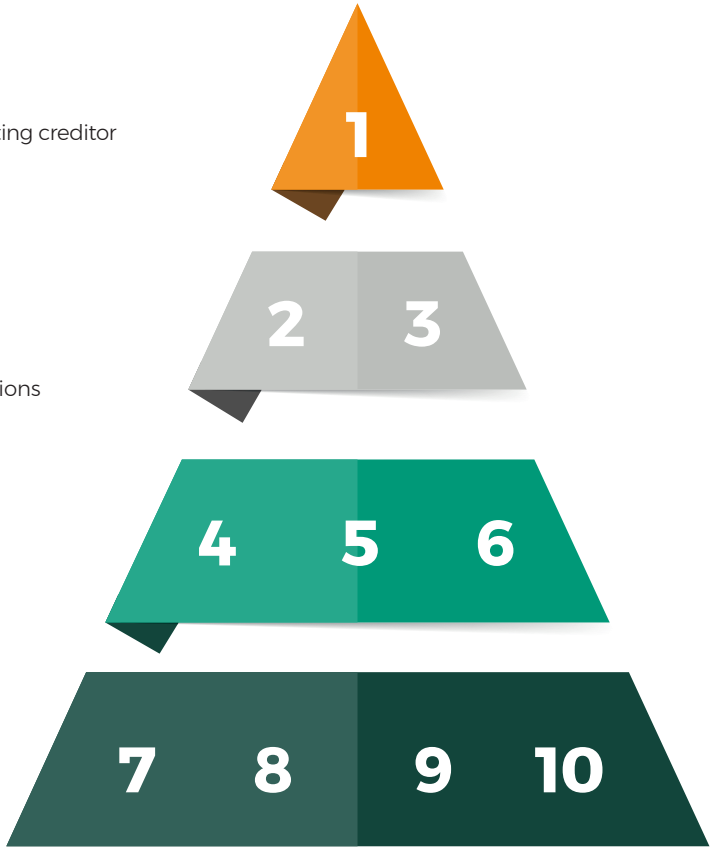
3 Notional pyramid

- Disproportionate financial sacrifice caused to the dissenting creditor

- Participation loans and insolvency proceedings
- Rescission of a contract subject to English law

- Ranking of claims derived from costs of pending litigations
- Assessment after a breach of a creditors' agreement
- Disposal and consent of the mortgage creditor

- Appeal of the termination of a lease agreement
- Improper compensation and insolvency proceedings
- Cash as a necessary asset for the continuity of trading
- Access to the Register after an "express insolvency proceedings"



1 Court homologation of refinancing agreements and existence of disproportionate financial sacrifice ("Abengoa II: challenge of the MRA" case): judgment by Sevilla Commercial Court no. 2 on September 25, 2017

The court held that the homologated refinancing agreement of the Abengoa group involved a disproportionate financial sacrifice for the challenging dissenting creditors, very briefly, by the following four independent reasons considering that:

i. The lack of viability determines the existence of disproportionate financial sacrifice: the fact that the continuity of the business activity is merely possible is not sufficient; what is relevant instead is that the chances that such continuity happens are higher than the chances that continuity does not occur. Evidence had been provided that, against what was determined by the independent expert (whose eligibility is deemed questionable by the court), not enough chances exist that a number of defendant companies will comply with the viability plan and, therefore, it is most likely that they will not be able to continue trading;

ii. the 97% reduction and 10-year rescheduling arrangements contained in the standard proposal for restructuring imposed on the dissenting creditors were unnecessary, and therefore excessive from the standpoint of the viability plan itself;

iii. the sacrifice imposed on dissenting creditors was excessive compared with the treatment given to the creditors adhered to the refinancing agreement (by comparing both the two alternatives contained in the refinancing agreement –standard terms and alternative terms -, and from the standpoint of the treatment given to the "fresh money" creditors which, in actual fact, did not qualify as such); and

iv. the legal requirement on the necessary valuation of the in rem collateral that some of the creditors adhered to the refinancing agreement owned had been disregarded.

The court considers that the homologated agreement shall not extend to those dissenting creditors who challenged the homologation, whose claims shall remain unimpaired (vid. orders dismissing the requests for clarification and complement dated, respectively, October 3rd and October 27th, 2017).

Moreover, the court held that, in line with what was declared by the court by its judgment dated October 24th, 2016 ("Abengoa I: challenge of the Stand-Still"), through the judicial homologation procedure the effects of a refinancing agreement shall not be extended to contingent claims considering that claims are not financial debt according to Fourth Additional Disposition of the Spanish Insolvency Act.

Regarding the protection of the homologated agreement against clawback actions, the court affirmed that the court homologation of that agreement only protects it against clawback actions in insolvency proceedings, meaning that protection does not apply to any actions to be brought based on fraud.

2 Classification of participation loans as unsecured claims in insolvency proceeding on borrower: judgment by Madrid Provincial Appellate Court on March 24, 2017

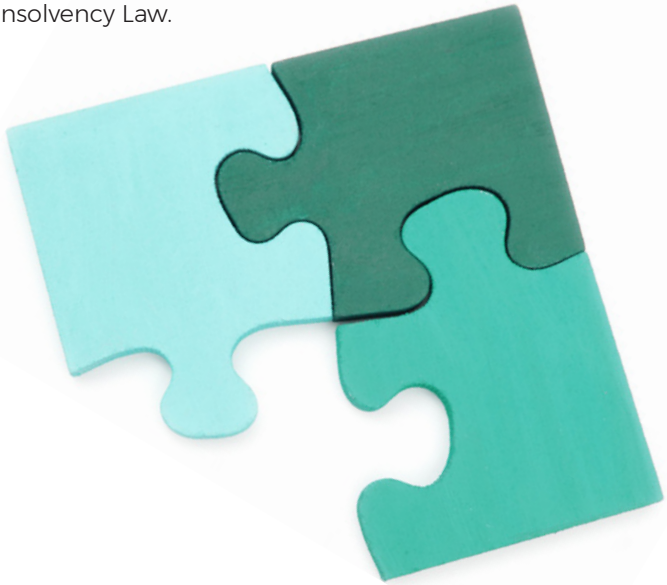
The grounds for subordination and priority for payment must be interpreted restrictively, and therefore participation loans under Royal Decree-Law 7/1996, of June 7, 1996 will be classified as ordinary claims unless a "justified" reason allows another classification.

3 Clawback action in an insolvency proceeding, against payments under a contract subject to English law: judgment by Palma de Mallorca Provincial Appellate Court on October 17, 2017

It is not allowed to claw back payments made by a company before the insolvency order. The payments were made to the legal and financial advisors who provided their services as part of the restructuring process of the company's group. Article 13 of Council Regulation (EC) No 1346/2000 on insolvency proceedings (now article 16 of the Recast Regulation (EU) 848/2015), precludes those payments from being clawed back where the contract is subject to a law of a Member State other than that of the State of the opening of the insolvency proceedings. It was English law in this case, and the Spanish court held, by applying the principles in the Vinyls judgment by the Court of Judgment of the European Union, that the insolvency manager failed to evidence the requirements in the 1986 Insolvency Act to challenge an act considered detrimental had been met.

4 Classification of a claim related to order to pay legal costs of lawsuits in progress when the insolvency order was made: judgment by the Supreme Court (Chamber One) on June 30, 2017

Any unfinished lawsuits at first instance when the insolvency order is made on one of the parties continue to be conducted in the interests of the insolvency, unless they are terminated through discontinuance or acceptance of the claim, or an out-of-court settlement. If the lawsuit continued after the insolvency order and the insolvency company was ordered to pay the legal costs, the claim arising from that order would be a post-insolvency order claim under article 84.2.3 of the Insolvency Law.



5 Assessment of insolvency proceeding after it was reopened due to breach of arrangement with creditors: judgment by Murcia Commercial Court no. 1 on July 12, 2017

If the assessment phase is opened by reason of a breach of a "soft" arrangement for the creditors, on which the assessment section had therefore not been opened earlier when it was approved, it is necessary to examine all the grounds submitted by the parties, rather than just adjudicate in the assessment section on steps taken after the insolvency proceeding was reopened due to a breach of the arrangement.

6 Prohibition on transferring mortgaged property without the mortgagee's consent when the price is below that agreed on arrangement of the mortgage: decision by the Directorate General for Registers and the Notarial Profession on September 11, 2017

Property may not be transferred at a price below the appraisal determined by mutual agreement by the parties when the collateral was established, except with the mortgage creditor's express consent. Mandatory nature of the requirements under article 155.4 of the Insolvency Law.

7 No need for prior payment or placement of a bond in respect of the owed rent in an ancillary insolvency proceeding for termination of a lease agreement: judgment by Barcelona Provincial Appellate Court on February 20, 2017

For an appeal to be admitted in an eviction proceeding on a leased property, the Civil Procedure Law requires prior payment or the placement of a bond in respect of the owed rent. That rule does not apply if an insolvency order has been rendered on the lessee, because in insolvency proceedings specific rules apply in relation to appeals, and these rules do not require any owed rent to be paid.

8 The liquidation of a contractual relationship is not restricted under the statutory prohibition on netting the claims and debts of a company in insolvency: judgment by the Supreme Court (Chamber One) on July 20, 2017

The netting of debts in the liquidation of a contract between the parties is not prohibited by article 58 of the Insolvency Law, in that it is a mechanism for liquidation of the contract ("ad hoc" netting) and not a netting of claims and debts under different contracts (strict netting).

9 Treatment of money or cash as a necessary asset for the debtor to continue trading: decision by Barcelona Commercial Court no. 7 on July 28, 2017

Money or cash is a necessary asset in an insolvency proceeding where the plan for the liquidation of the company's assets provides, as the preferred mechanism for that liquidation, the sale of the productive unit "as a going concern". This nature of cash as a necessary asset implies the stay of any enforcement proceedings that may exist on it, with an obligation for the creditor to refund the amounts collected after the date on which the enforcement proceedings should have been stayed.

10 Entry at the commercial registry of transactions for liquidation and distribution of assets of a company held to be wound-up following a "fast-track insolvency proceeding": Decision by the Directorate General for Registers and the Notarial Profession on August 30, 2017

The removal from the registry of the company as a result of its "fast-track insolvency proceeding" does not preclude registration of the resolutions of the shareholders' meeting, in that, besides falling outside the liquidation in insolvency, it is through them that the company is actually wound up, a liquidator is appointed, the final balance sheet is approved, the surplus assets are distributed and the company is declared liquidated and permanently extinguished.

4 Garrigues archives

1 PUBLICATIONS

- **Homologación judicial de acuerdos de refinanciación: viabilidad, irrescindibilidad e impugnación** *("Court homologation of refinancing agreements: making them viable, non-clawbackable and non-challengeable")* [García-Alamán de la Calle], Revista de Derecho Concursal y Paraconcursal, issue 27, Second Semester of 2017, Editorial Wolters Kluwer.

- **Los marcos de reestructuración en la propuesta de Directiva de la Comisión Europea de 22 de noviembre de 2016 (I)** *("The Restructuring Frameworks in the Proposal for a Directive of 22 November 2016")* [Thery Martí], Revista de Derecho Concursal y Paraconcursal, issue 27, Second Semester of 2017, Editorial Wolters Kluwer.

- **La inclusión de soluciones alternativas en un convenio no implica trato singular. Comentario a la Sentencia de la Sala Primera del Tribunal Supremo de 13 de marzo de 2017** *("The inclusion of alternative solutions in an arrangement does not imply special treatment. Comments on the judgment by the Supreme Court (Chamber One)* on March 13, 2017.") [Verdugo García], Revista de Derecho Concursal y Paraconcursal, issue 27, Second Semester of 2017, Editorial Wolters Kluwer.

- **Régimen de recursos contra las resoluciones judiciales dictadas en materia de enajenación de activos en el concurso de acreedores** *("Appeals against court decisions rendered on disposals of assets in insolvency proceedings")* [Lama Salinas], Revista de Derecho Concursal y Paraconcursal, issue 27, Second Semester of 2017, Editorial Wolters Kluwer.

- **"España - La subasta electrónica, el acceso de todos"** *("Spain – The electronic auction, access for all")* [González Pajuelo], La Verdad.

2 EVENTS

- **Loan Market Association, Madrid Early Evening Seminar,** September 13, 2017.

  At this seminar organized by the *Loan Market Association* ("LMA"), Garrigues partner Gaspar Atienza explained the status of the European Commission's investigation into syndication processes. Garrigues partner Juan Verdugo discussed the impact of Brexit on syndicated loans and credit facilities subject to English law. He focused on the general characteristics of the UK Withdrawal Act and the new post-Brexit scenario for Spanish security and collateral, financial security and contractual netting agreements, and clawback actions against syndicated agreements subject to English law in cases of insolvency proceedings in Spain on the borrower.

- **XI Encuentro en Galicia de Profesionales del Derecho Concursal y Societario,** ("XI Meeting in Galicia of Bankruptcy and Corporate Law Professionals"). Consello Galego de Economistas, September 21, 2017. Santiago de Compostela.

  Garrigues partner Adrián Thery took part as speaker at the panel "*New European Insolvency Regulation and Proposal for a Directive on Restructuring*", which was moderated by Garrigues partner Jesús Ángel Sánchez Veiga.

- **Nuevo Reglamento Europeo de Insolvencia, acciones de reintegración y concurso internacional tras la Sentencia del TJUE de 8 de junio de 2017 (Vinyls Italia SpA c Mediterranea di Navigazioni SpA),** ("New European Insolvency Regulation, clawback actions and international insolvency proceedings following the CJEU judgment of June 8 2017 (Vinyals Italia SpA v Mediterranea di Navigazioni SpA), Fundación para la Investigación sobre el Derecho y la Empresa ("FIDE"), October 2, 2017, Madrid.

  This session was moderated by Garrigues partner Juan Verdugo and Iván Heredia, lecturer on private international law at Universidad Autónoma de Madrid and senior associate in the Garrigues Restructuring and Insolvency Department took part as speaker. The participants discussed insolvency clawback actions and the "veto" rule or inability to apply the law of the State of the opening of proceedings when the parties chose as the law governing the contract the law of a different Member State (article 16 of the Recast Regulation on insolvency proceedings). They looked particularly, from a practical perspective, at the issues raised by the recent CJEU judgement of June 8, 2017 in the "Vinyls" case.

- **"Preventive restructuring: sunset on insolvency?",** Insol Europe Annual Congress. October 5-8, 2017, Warsaw (Poland).

  Garrigues partner Adrián Thery chaired the panel entitled "*The EU Commission Directive Proposal: scope, contents and future legislative process*". The forum participants debated the implications of the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

- **"International Restructuring Symposium",** Droit & Croissance/Rules for Growth. January 18-19, 2018. French Ministry for the Economy and Finance, Paris (France).

  Garrigues partner Adrián Thery chaired the panel entitled *"For an efficient bankruptcy law in the context of the Banking Union and the Capital Markets Union"*.

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