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Spain: Insolvency Litigation Funding

Borja García-Alamán, Jose María Gil-Robles, Adrián Thery and Juan Verdugo
Garrigues

The economic crisis that started to engulf Spain in 2007, which the country has been shaking off little by little, has spurred players in the restructuring market to step out of their comfort zone and go down lesser-trodden paths in Spain. This means players are exploring new alternative sources of funding to conventional bank lending; similarly, investors, encouraged by experiences in other markets, are incessantly researching any mechanisms that will enable them to move their capital in their constant search for greater returns. Litigation funding has been moving towards the point where the interests of all of these appear to converge.

The truth is that until now little regard has been given to this system in Spain. Known in other jurisdictions (United Kingdom, Wales, Australia and the United States already have extensive experience in these matters, and they have also recently gained momentum in Singapore, Hong Kong and Germany), litigation funding has had more notable acceptance where it is associated with arbitration litigation, above all in investment arbitration, primarily because of the high access costs. Litigation funding could be described as sporadic in Spain, although some of these incursions, occurred in relation to insolvency proceedings, have recently been on the receiving end of media attention.

By this we mean the request for arbitration to the International Centre for Settlement of Investment Disputes (ICSID) made by tourism group Marsans against Argentina in relation to Argentina's seizure of Aerolíneas Argentinas SA and Austral-Cielos del Sur SA plus their subsidiaries. In a decision rendered on 22 December 2010, the judge examining the insolvency proceeding on the company that brought the arbitration proceeding (Teinver SLU) authorised its insolvency receiver to sign the agreement previously covenanted with Burford Capital, under which Burford Capital agreed to finance the costs arising from the arbitration process in exchange for a success fee calculated proportionately to the amount that would be obtained if the claim in the request for arbitration was upheld. In this avant-garde decision – at that time the Spanish Insolvency Law was only six years old and until then litigation funding was unheard of in Spanish insolvency proceedings – the judge gave free range to this financing model after considering the sum claimed in the arbitration proceeding, the small amount of cash in the insolvent company's coffers, and its inability to obtain bank loans as a result of its equity deficiency. Similarly, although the agreed fee would take a large chunk out of the amount achieved in the arbitration proceeding, the judge held it reasonable, in that:

- the funder had undertaken to advance all the arbitration costs on a non-refundable basis, no matter the outcome of the lawsuit;
- those costs could total US$12 million;
- the funding had a high risk associated with it;
- it was an international arbitration proceeding that was expected to be drawn out over a long period of time; and
- there was uncertainty over the enforcement of a hypothetical favourable award.

On 21 July 2017, ICSID rendered an award in favour of Teinver SLU and ordered Argentina to pay indemnification amounting to more than US$300 million plus interest, though it appears that Argentina has not given up the battle and will fight that decision.

Similarly, Burford has also signed a litigation funding agreement with Spanish companies Petersen Energía Inversora SAU and Petersen Energía SAU, which have been under insolvency proceedings since October 2012, to fund the costs of the lawsuit commenced by those companies against Argentina, in relation – put very briefly – to the seizure from Repsol of the shares it held in energy company YPF, and breach of the by-law duty to launch a tender offer for the other shares on taking control of YPF.

To date, the biggest beneficiary in these disputes has indeed been the funder: over 2017 Burford sold a 25 per cent share of the amount it would be entitled to receive in the *YPF* case, and in March 2018, Burford notified of the sale of the entitlement in the *Teinver* lawsuit with a 736 per cent return on invested capital. This proves that litigation funding is not just a means of providing an extremely useful model for companies under insolvency proceedings and with limited funds, but can also reap rewards for companies accepting to fund petitions with merits. In the wake of these sorts of precedents, this funding system is emerging as an attractive investment model that is starting to find an opening in the Spanish restructuring market.

In the following sections of this article we briefly describe some of the issues that may arise in relation to this funding model.

Disclosure of the funder's existence

As mentioned above, litigation funding is an *inter partes* agreement with terms known only by the funder and funded party, since in principle it binds only the two of them. In fact, they usually contain a confidentiality clause to ensure that the terms of the document are not visible to others, most especially, the size of the funder's fee. Similarly, and unless there are special circumstances (as happened in the *Teinver* case, in which the judge examining the insolvency proceeding on the funded party had to give authorisation for it to be able to sign the agreement), funder and funded parties do not usually have any intention to share with others that the participation in the lawsuit of one of the litigating parties depends on the funding being provided to it.

Despite this, practice has placed limits on the participants' intentions in litigation funding, and in many cases they have had to disclose the existence of that legal relationship to others. At times, the disclosure of that agreement aims to avoid potential conflicts of interest with any of the parties taking part in the dispute, in particular with the arbitrator or even with the judge. It is not unusual for the decider, at an earlier date or while the lawsuit is taking place, to have advised the funder, or even participated in another lawsuit in which the funder was an interested party; in this case, a great many scholars believe it reasonable for the funded party to state who is funding its participation as litigant.

Avoiding the existence of a potential conflict of interest (which is a rare occurrence anyway) clearly should not be the basis for having, always and in absolutely every case, to disclose the existence of the funding. For that reason, the funder ought to exercise responsibility and diligently assess whether its participation as funder 'in the shadows' of one of the litigating parties, and its interest in the lawsuit, may endanger in any way the independence or impartiality of the deciding

authority. We say that this examination must be carried out with great care, because the funder must keep in mind that, if a decision is taken and proves to be a mistake after all, it will probably derail the proceeding or, if the proceeding has already concluded, give rise to the decision of that proceeding being challenged or even rendered null and void, which would be detrimental to both funded party and the funder's own investment in the lawsuit. A wrong assessment of a potential conflict of interest plainly carries grave consequences.

It is doubtful whether equality of arms may be invoked as justification for making litigants disclose whether they are being funded by another, as found in an isolated judgment. Equality of arms is a principle that must prevail in any lawsuit, so the deciding authority must ensure that it is preserved at all times. We consider, however, that the fact of one of the parties participating in a lawsuit financed by another does not breach that principle; the principle of equality of arms will continue to prevail, regardless of whether there is litigation funding or not. Similarly to how this principle will not be breached by reason of the varying degrees of wealth of the confronted parties, we believe it will not be so either if one of them takes part with financial support.

If it has been determined necessary to identify the person participating as funder, it is arguable whether the funded party has to share with the other side in the dispute or with the deciding authority the specific terms of the funding agreement. The predominant view is that the terms of the clauses covenanted between funder and funded party are irrelevant to the course of the lawsuit; only certain isolated judgments held that disclosure of the funder's existence must be done in broad terms, including also the wording of the funding agreement, although the underlying reason for that decision was to preserve a future award of costs (an issue we deal with below). We believe, therefore, that if identification of the funder seeks to avoid the appearance of potential conflicts of interest, they undoubtedly will not be affected by the greater or lesser amount of any fee that may have been covenanted in the agreement or by any other covenants it stipulates. Therefore, since the document is only of interest to the signing parties, it appears reasonable that its terms should stay out of the lawsuit.

Security for costs

The law on court proceedings in Spain allows the parties to request preventive measures, usually at the beginning of the proceedings, to ensure that a future judgment will be able to be enforced. That provision is ordinarily designed to be used by the claimant if a judgment is rendered in its favour but that judgment cannot be implemented because:

- the defendant does not have enough cash to pay the ordered amount if it is a cash sum;
- for any reason the disputed asset is no longer in its possession or has gone astray, if delivery of the asset has been ordered; or
- for any other reasons of any type giving rise to the risk of the ruling in the judgment not being implemented.

The provisions on injunctive remedies in Spanish procedural law, however, were not introduced in principle to ensure the payment of future costs by the litigant losing the case.

In arbitration proceedings it is not uncommon for the respondent in the proceeding to request that the deciding authority adopt some type of preservation measure that will ensure that the ordered costs will be able to be paid if the claimant loses the lawsuit. This measure (known in common law countries as 'security for costs' and in civil law countries as *cautio judicatum solvi*) has gained greater importance and has proved even more controversial where one side of the lawsuit has signed a litigation funding agreement.

The existence of this agreement alone is not a sufficient basis for adopting that measure. It must be remembered that the process for granting an injunctive remedy is not an automatic one, but rather, the petition must be drawn up with careful attention regarding its scope and, especially, the grounds for granting it: *fumus boni iuris* or the appearance of good right (in other words, the applicant must produce evidence to the decider from which it may be determined provisionally whether there are elements to conclude that the action may be successful); and *periculum in mora*, which requires the applicant to explain the scenarios that would prevent or hinder implementation of any protection that might be granted in the judgment on the lawsuit. Moreover, injunctive remedies are 'preventive' measures, and therefore cannot be used in every case, but only if there are exceptional circumstances that inexcusably require their adoption.

Similarly, there is a variety of reasons that may cause a litigant to decide to sign a litigation funding agreement: one of the most common is the absence of funds to meet the costs of a lawsuit, although this system may also be used to diversify the risks of the litigant's business, or even to avoid a dispute in which a large amount is at stake having an adverse effect on its financial statements. It would be in the first of these examples that a request by the deciding authority for the funded party to provide security for costs would be justifiable, because failure to pay costs might seem more likely for a party that is insolvent or lacks funds.

Litigation funding and assignment of claims

A similar transaction to litigation funding is an assignment of claims. An assignment of claims involves a creditor transferring its claims in exchange for a price, after which the transferee owns the claim and it is the transferee who will later claim payment from the debtor, in or out of court. Whereas in litigation funding the funder has the right to receive part of the proceeds obtained from a favourable judgment on the lawsuit, in assignment of claims the assignor severs all ties with the original legal relationship, so the assignee will keep the whole amount it receives for the claim.

Assignment of claims and litigation funding are somehow similar but cannot be treated as equivalents. Although a litigation funding agreement allows a great deal of freedom of negotiation between the parties to agree on its terms, the funder will generally have an 'expectation of receipt of something of value' over the amount that the funded party might obtain if its petitions in the lawsuit are upheld, while the covenanted fee between the parties does not entail an assignment of claim to the funder in respect of part of that amount. In fact, following the conclusion of a successful lawsuit, the funder will not be able seek payment of its remuneration from the defeated litigant, because the litigation funding agreement does not transfer that remuneration to it; by contrast, its legal relationship was forged with the funded party alone, and it is when this party receives the sum determined in the lawsuit that the covenanted amount will be paid to the funder.

Moreover, it is not hard to see how a creditor going to court with the funding provided by a litigation funding agreement, worn down at that point by the debtor not paying its debt or by a long-running court proceeding without a solution on the horizon, may decide to end this uncertainty and reach an agreement to assign its claim to the funder, which is when it does assign its position in the lawsuit to the funder.

In the scenario we have just described, the funder must have regard to article 1535 of the Spanish Civil Code, which allows the debtor to discharge the sold disputed claim by paying the assignee the price it had paid for it, together with any costs the assignee had incurred and the interest that had arisen on the price from when it was paid. The debtor may make use of this right of redemption (known as an 'Anastasian' right because it was first conceived in Anastasian Roman law) within nine days following the date when the assignee claims payment of the debt. It is becoming increasingly common for debtors to make use of this right for the purpose of discharging claims acquired by

investors, which has given rise to an assortment of different court decisions, meaning the solution will depend on the specific circumstances. If there is a litigation funding agreement signed with a creditor owning a single claim, and it is considered a 'litigious' debt because still a dispute has been raised on its existence and enforceability, the assignment of that claim to the funder will trigger an option for the debtor to make use of its right of redemption. If, however, the litigation funding agreement is covenanted in relation to a portfolio of claims rather than a single claim and price of the assignment was not determined according to the amount of each claim individually but jointly (which is common practice for portfolios of claims), Spanish courts have mostly been holding that the debtors for the assigned claims could not exercise the right of redemption, even being 'litigious' claims, because the assignment is considered a bulk sale or a sale 'on bloc'.

Despite the complexity of some elements of litigation funding, it seems obvious to us that this new financing model is here to stay and will probably give rise to the same issues in Spain as in other jurisdictions, such as whether codes of conduct should be drawn up for the funders, the chance for funders to club together to support industry and defend the common good, or even the various mechanisms for patenting artificial intelligence systems that will enable the funder to calculate a lawsuit's likelihood of success.

Borja García-Alamán
Garrigues

Borja García-Alamán has been a partner at Garrigues since 2008 and has practised law at the firm since 1997, providing advice on business distress situations, out-of-court restructuring processes, workouts and Spanish Schemes (homologación judicial), pre-insolvency situations and insolvency proceedings. He also has extensive experience in civil and commercial litigation and in arbitration proceedings. He is renowned in the sector for his experience providing strategic advice to debtors in situations of actual or imminent insolvency, and for having participated in many of the most high-profile insolvency proceedings in Spain (and with a cross-border dimension). An expert on directors' liability and clawback, he is also frequently engaged by creditors to defend or protect their claims, guarantees or contractual positions, strategic acquisitions of companies, production/business units or shareholdings in distress situations, distress debt transactions and claims acquisitions. His career has been singled out for praise in the most prestigious international legal directories for many years: in *IFLR1000* (Leading Lawyer), *Chambers and Partners Global* and *Chambers Europe*, *The Legal 500* and *Best Lawyers*. He has been a lecturer in insolvency law on the master's degree in business law at Centro de Estudios Garrigues since 2009, and he is also a regular speaker at conferences, focusing mainly on insolvency matters and companies in distress. He is a member of the Madrid Bar Association and a founding member of the Spanish Chapter of the experts association Turnaround Management Association (TMA).

José María Gil-Robles
Garrigues

José María Gil-Robles is a partner in the mergers and acquisitions team, being one of the partners in charge of the private equity, hedge funds and distressed M&A groups.

Within the distressed M&A group, he regularly advises hedge funds and other distressed players in the sale and purchase of credit portfolios (performing or non-performing, with or without collateral), corporate debt, shares in insolvent (or near insolvent) companies, regional or local authorities' debt to pharmaceutical or construction companies or financial investors (institutional or retail), as well as on the provision of hybrid financing to Spanish companies, debt refinancing and operational restructuring. Prior to joining Garrigues, he worked as a financial analyst and portfolio manager at Inversiones y Estudios Financieros, SA (SAFEI) (1987–1989), as well as an auditor of energy companies at Arthur Andersen (1989–1990). In 1990, he joined the firm as member of the financial tax department, and later on as member of the corporate/commercial department. Between 2007 and 2009 he was the partner in charge of the London office, but he is now based in Madrid. He has been singled out as a leading private equity and corporate M&A practitioner by international directories such as *Chambers*, *Who's Who Legal* and *Practical Law Company*.

Adrian Thery
Garrigues

Adrian Thery is a Madrid-based partner at Garrigues' restructuring and insolvency department, where he advises debtors or investors on out-of-court or in-court restructurings and insolvency proceedings, both domestic and cross-border. He is a member of the group of experts on restructuring and insolvency law assisting the European Commission in the preparation of legislative proposals and policy initiatives. Three of the measures Adrian devised in different restructurings have been recognised by the FT Innovative Lawyers Awards (2009, 2011 and 2013 editions). Some of the innovative solutions he has implemented have been subsequently incorporated into the Spanish Insolvency Act. Adrian is singled out in the main international legal directories (*Chambers*, *IFLR1000*, *The Legal 500*, *Who's Who Legal*, among others) for his 'creative vision', 'technical skills' and 'strategic abilities'. His full CV is available at www.garrigues.com.

Juan Verdugo
Garrigues

Juan Verdugo is a partner in the firm's restructuring and insolvency department. He is currently, in some way or another, advising hedge funds, investors and banks on the buy-side and sell-side of the foremost NPLs and REOs deals marketed in Spain, successfully closing a number of them. He has amassed a wealth of experience in refinancing distressed businesses, the acquisition of debt from banking syndicates, the purchase of distressed companies and assets and defending clients in asset clawback actions. Also worth noting is his experience in the area of cross-border insolvencies and in advising foreign investors on bids to acquire a controlling stake in distressed companies through loan-to-own tools. Since 2008, Mr Verdugo has regularly featured in the main international legal directories, which have stated that 'he is capable of having a fantastic interaction with the court and anticipating how the parties will behave' (*Chambers Global*, 2015) and that 'he is really creative; it seems as though creating jurisprudence is something he enjoys doing' (*Chambers Europe*, 2017). *Chambers Europe*, 2018 again endorsed Mr Verdugo, gathering positive feedback from clients who reveal that he has 'superb skills as insolvency litigator with unrivalled track record in claw-back actions, collateral enforcements and directors' liability'. According to the Financial Times, Mr Verdugo led the team that advised on and closed the most innovative restructuring deal in Spain (Jofel Industries, 2016) during insolvency proceedings and in the face of dissenting creditors, combining restructuring tools meant for different scenarios and new to Spain. He also sits on the World Bank Panel of Experts for the annual reports on 'Closing a Business' and 'Getting Credit'.

GARRIGUES

Hermosilla 3
28001 Madrid
Spain
Tel: +34 91 514 52 00
Fax: +34 91 399 24 08

Borja García-Alamán
borja.garcia-alaman@garrigues.com

José María Gil-Robles
jose.maria.gil.robles@garrigues.com

Adrian Thery
adrian.thery@garrigues.com

Juan Verdugo
juan.verdugo.garcia@garrigues.com

www.garrigues.com

Garrigues was the first Spanish firm to set up a restructuring and insolvency department, inspired by the Anglo-Saxon model. Our success lies in tailor-made advice to litigation funds, hedge funds, debt funds and other relevant players of distressed markets looking for successful deals related to listed companies, industrial, audiovisual, steel and defence companies, to name a few. Long before Spanish legislation allowed debtors to refinance their debt in a stable legal environment, Garrigues acted in and successfully negotiated debt refinancing arrangements by using innovative tools. When the Spanish law incorporated these tools (2009), Garrigues utilised them to maximum effect. Even today Garrigues continues to advise different stakeholders in the context of the so-called Spanish Scheme of Arrangement, promoting the creation of case law that contributes to shape the legal contours of these novel institutions (Abengoa, 2017). Having an experienced banking and finance team and, at the same time, being able to call on the best experts in restructuring (including former judges) enables us not only to assemble multidisciplinary teams (other firms already do this) but also to employ restructuring techniques that are tried and tested and effective in any of the phases a company may be going through. When advising investors, other firms find it hard to manage complex and urgent NPLs or REO transactions. Garrigues achieves a smooth transition from legal due diligence processes to the SPA phase by involving its specialists in insolvency, real estate and financing from the very outset.

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