GARRIGUES Newsletter

# Restructuring and Insolvency Work

**November 2014**

## Index

## I. New legislation

### 1. *Garrigues teams up with the Official State Gazette on publication of Code of Insolvency Law*

The Code of Insolvency Law is now available on the Official State Gazette website. This document was prepared in conjunction with the professionals in the Restructuring and Insolvency Department at Garrigues on the selection, organization and review of the legislation. It can be found **here**.

This is the second time Garrigues has worked with the Official State Gazette on producing a code (the Code of Pharmaceutical Law was presented in July) and this partnership is expected to produce new compendia for this collection.

The Code of Insolvency Law is available to download free of charge in PDF and ePub formats, able to be stored and read on electronic devices.

### 2. *Royal Decree-Law 13/2014, of October 3, 2014, adopting urgent measures in relation to the gas system and the ownership of nuclear power stations*

On October 4, 2014, the Official State Gazette published Royal Decree-Law 13/2014, of October 3, 2014, adopting urgent measures in relation to the gas system and the ownership of nuclear power stations. Its provisions basically relate to the undersea storage site for natural gas, known as the Castor Project.

The decree-law provides for the termination the operating concession for that site located in the Mediterranean, and the hibernation of its facilities.

It confers management of the site on ENAGÁS TRANSPORTE, S.A.U. ( "ENAGÁS") and requires ENAGÁS to pay €1.350 million, the quantified value of the investment, to the former concession holder (ESCAL UGS S.L.). ENAGÁS will recoup that sum from the Spanish gas system over thirty years.

What is particularly striking about this decree-law is that ENAGÁS will hold a collection right against the Spanish gas system with a unique priority for payment (the "Collection Right"), to be compensated for those payments. The characteristics of the Collection Right held by ENAGÁS are, briefly:

- The Collection Right will be available without any restrictions to ENAGÁS, or its subsequent owners, and, therefore, all or part of it be may be assigned, transferred, discounted, pledged or encumbered to the benefit of third parties, including asset securitization funds or any other special purpose or other vehicles, within or outside Spain. These parties will never be treated as persons "specially related" (insiders) to the assignor or pledgor.

- If the assignor enters into an insolvency proceeding, the first or later assignees will benefit from an absolute right of separation over that Right.

- The assignment of the Collection Right can only be terminated or challenged by the insolvency manager if it is evidenced that it was performed with fraud against the other creditors.

- The pledge or assignment securing the Collection Right will always be treated as a financial security agreement for the purposes of Royal Decree Law 5/2005.

- The last sentence in article 90.1.6 of the Insolvency Law (*Ley Concursal or* "LC") will not apply to the Collection Right; in other words, no further requirement will be laid down for the claim secured with the Collection Right to be recognized as a specially preferred claim in an insolvency proceeding on the assignor.

  This will also apply to any pledge or assignment as security of the bank accounts into which the payments relating to the Collection Right might have to be paid, in addition to the rights derived from any assignment agreement for the Collection Right, should the case arise.

The new royal decree came into force on the date it was published in the Official State Gazette.

## II. Case commentaries

### *1. Decision dated October 23, 2014 rendered by Murcia Commercial Court number 2*

**Article 5bis LC.—Application for stay of provisional execution of judgment on basis of earlier filing of notice under article 5bis LC ("pre-insolvency").—First instance court hearing application for stay of execution, besides allowing application, ordered removal of attachments ordered on balances and accounts of party subject to enforcement, after submission of notice under 5bis, by considering them necessary assets for company to continue trading.**

**Commentary**

The debtor filed with Almería Commercial Court number. 2 the notice under article 5bis of the Insolvency Law, with an express request for it to be kept secret.

Between the filing of that notice and the order to admit it, the Murcia Commercial Court handling provisional execution of a judgment against the company, ordered an expansion of the attachment to take in its checking accounts and outstanding VAT refunds.

The debtor subject to enforcement filed a submission against this, requesting a stay of the provisional execution, and the rendering null and void of, any steps taken after the notice under 5bis and, in particular, the rendering null and void of the ordered expansion of the attachment. Attached to that petition was a certificate issued by the Commercial Court clerk evidencing the filing of the notice under article 5bis of the Insolvency Law.

In its decision on this case, the court conducting the provisional execution of the judgment ordered for: (i) the provisional execution to be stayed; and (ii) the attachments on the checking accounts and outstanding VAT refunds of the debtor subject to enforcement to be lifted, because both were considered to be necessary assets for the company to continue trading.

The judge concluded that the lifting of the attachments on the assets necessary for the company's operations must be an inescapable effect of the filing of the notice under 5bis. These attachments, the judge pointed out at the end of his analysis, were an obstacle to the debtor securing any refinancing agreements in the period granted under 5bis.

## III. Headnotes

### *1. Court decisions on asset clawback actions*

This section contains summaries of the most recent decisions on asset clawback actions, particularly those which examine whether or not the transaction subject to clawback was for consideration, the option to claw back the distribution of dividends made in the two years before the insolvency, and the effects of clawing back a sale and purchase transaction.

#### *1.1 Supreme Court*

1.1.1 Judgment dated July 24, 2014 rendered by Chamber One of the Supreme Court

Articles 58 and 71 LC.-- Prohibition on set-off and asset clawback action.-- The lower court judgments, dismissing the plaintiffs' arguments, held that there were claims payable to the appellants as well as a debt owed by them to the insolvent party. Those judgments also ordered clawback of payments made by the insolvent party to the company director and the reversal of the resolution of the shareholders' meeting on the distribution of dividends and clawback of the payment of those dividends.-- First ground for cassation: upheld: Article 58 LC prohibits the setting of the insolvent party's claims and debts as these are subject to the *par conditio creditorum* (equal treatment of creditors) rule , unless the debt met the requirement of being liquid, due and payable before the insolvency order was made. These rules do not apply to any set-off which arises as a result of the settlement of the same contractual relationship.-- Naturally, if the portion of the claim owed by the principal to the contractor for the performance of the works has been withheld to secure timely performance of the contractor's obligation, the owner of the works may use the amounts withheld to pay the compensation for delay.-- Second ground for cassation: dismissed: a debt paid during the period of suspicion spanning the two years before the insolvency order is, as a general rule, and insofar as the debt was due and payable, justified, and does not constitute detriment to the assets available to creditors. There may, however, be exceptional circumstances which prevent certain payments from being justified, if they breach the *par conditio creditorum* (equal treatment for creditors) principle.--Not proven that the company director had performed any other services falling outside the duties attached to his office as director which would have justified the payments received, with the result that those payments were not owed as they did not meet the requirements set out in the bylaws in order to trigger the right to receive such payments: the permissiveness of the shareholders, who consented to the remuneration, cannot be relied upon as against third parties, whose interests have been harmed, and therefore the estoppel doctrine cannot be pleaded in relation to the shareholders: directors' remuneration does not constitute a financial or business transaction nor was it paid on arm's length terms. Accordingly, it does not fall within the acts in the ordinary

course of business that cannot be clawed-back under article 71.5 LC.-- Third ground for cassation: dismissed: the resolution on the distribution of dividends is an act of disposition which may be reversed if it was adopted in the two years before the insolvency order and is not justified.-- The resolution on the distribution of income may be fully clawed-back if the detriment affects the whole of the sum determined for payment to the shareholders, or partially clawed-back, up to the amount of the detriment.-- For an act of disposition to be detrimental to the assets available to creditors, it is not necessary for it to have contributed to the occurrence or aggravation of the insolvency, nor need the company already have been technically insolvent when the act was executed.-- The effect of this clawback is that the shareholders forfeit their right to receive the dividend, if it was not distributed to them before the insolvency order was made, or, if it was, they are required to return the dividend to the assets available to creditors.-- The shareholder status of the recipients of the payments, the characteristics of the claims (dividends) and the fact that, when the payments were made, the company had "concealed" large losses, means that these payments, although owed, were unjustified.-- Upon reversal of the shareholders' resolution, the right to receive the dividends is rendered null and void and the return of any amounts already received is not conditional on the refund of the initial contributions, as there is no relationship of reciprocity between them.

1.1.2 Judgment dated September 4, 2014 rendered by Chamber One of the Supreme Court

Article 71 and Transitional Provision 1 LC.-- Asset clawback action: Pledge over a bank deposit created by the insolvent company pursuant to Royal Decree Law 5/2005 ("RDL 5/2005") to the benefit of a financial institution as security for a third-party debt.-- The commercial court clawed back the pledge as the insolvent party had received nothing in return. The provincial appellate court dismissed the appeal to a superior court lodged by the bank.-- Cassation appeal: dismissed.-- The appellant argued that the insolvency manager should have evidenced that the pledge had been created with fraud against the creditors, as provided for in article 15.5 RDL 5/2005, in its current wording: disallowed: the appellant sought implementation of the current wording of article 15.4 RDL 5/2005, which refers to "fraud against the creditors" even though, when the case was decided on, the previous wording was in force and applicable, and that wording only referred to the fact that the financial security had to have been provided "to the detriment of the creditors".--The Supreme Court disallowed retroactive application of the Insolvency Law and other statutory provisions, in accordance with the general principle of "*tempus regit actum*", which prevents earlier legal relationships being made subject to later provisions, and does not allow cases not contemplated by them to be interpreted broadly, except in the case of fundamental rights and public freedoms: the invalidity of the pledge as a consequence of the asset clawback action is not a "civil penalty", but is instead one of the effects of the clawback mechanism.-- The financial security that was provided harmed the creditors' expectations of collection, and proof of the fraud against the creditors could not be demanded when the decision was rendered: the pledge was established as security for a third-party debt without any consideration whatsoever for the insolvent party, with the result that it entailed an act for no consideration to the detriment of the assets available to creditors.

*1.2 Provincial Appellate Courts*

1.2.1 Judgment dated July 18, 2014 rendered by Madrid Provincial Appellate Court

Article 71 LC.-- Asset clawback action against the establishment of a mortgage over a property belonging to the insolvent party as collateral for professional services provided to the "controlling" shareholders and to companies in the same business group as the insolvent party, as the transaction was regarded as involving an act of disposition for no consideration or, in the alternative, an act causing detriment to the insolvent party.-- Cassation appeal: dismissed.-- Group of companies in the broad sense of the term. "Upstream/downstream security" is for consideration even though the trade-off for the creditor in exchange for the advantage it obtains from the guarantee lies not with the insolvent provider of the collateral but with the debtor. In groups of companies, the advantage obtained by the insolvent party may be indirect, in that it works in favor of strengthening the group. The presumption that a transaction is for no consideration is not appropriate when analyzing a transaction involving a group of companies to which both the principal debtor and the mortgaging insolvent company belong.-- The Chamber held that it was arguable whether the mortgage was "upstream/downstream" collateral, in that it was provided after some of the secured professional services had already been provided.—Provision of collateral for pre-existing obligations which, moreover, were the responsibility of a third-party. Detrimental act: the secured professional services were provided by the creditor to the "controlling" shareholders and to companies in the same business group as the insolvent party, without the insolvent party obtaining any past or future benefit from those services. The provision of the collateral did not entail any direct or indirect benefit for the insolvent party.-- No intertwined assets between the insolvent party and its controlling shareholder or other group companies: the concept of a group does not weaken the principle that each group member has its own personality, since it involves independent entities each carrying on separate business activities.

*1.3 Commercial Courts*

1.3.1 Judgment dated June 27, 2014 rendered by Madrid Commercial Court No. 7

Article 71 LC.-- Asset clawback action against a payment guarantee (*fianza*) and pledge of collection rights by the insolvent party to secure a debt owed by a group company.-- The insolvency manager claimed that this was an act for no consideration. Dismissed: since the presumption of a commercial payment guarantee provided for no consideration, as set out in article 441 of the Commercial Code, prevailed, the burden was on the defendant financial institution to prove that the provision of the guarantee and pledge entailed some form of economic/financial advantage for the insolvent party: the court confirmed that the guarantee and pledge in respect of which clawback was sought secured the loan provided exclusively to a company in the group, but its purpose was to refinance another, earlier, loan, which remained unpaid, in respect of which the insolvent party was a joint and several guarantor.-- The court held that if the insolvent party had not secured the second loan, the initial unpaid loan could have been enforced, which would have diminished the assets of the insolvent party. The court held that that the insolvent party clearly had an individual interest in the provision of the guarantees and the act could not be regarded as "for no consideration".

*1.4 Directorate-General of Registers and the Notarial Profession*

1.4.1 Decision of the Directorate-General of Registers and the Notarial Profession dated August 2, 2014

Article 73 LC.-- Effects of a judgment clawing back a sale and purchase transaction: the court ordered the purchaser to return the property to the insolvent party and also ordered the removal of registry entries made as a result of that transaction. At issue was whether the court order could instruct the removal of a mortgage registered after the sale and purchase transaction, if the mortgagee had not been a party to the court proceeding.-- For the removal effects of the judgment to have binding force and for that judgment to affect holders of subsequent entries – where no provisional noting of the application for a decision had been made before those entries – those holders must, at least, have been summoned in the proceeding. Since no provisional noting of the application had been made and given that the holder of the later mortgage had not been summoned in the proceeding (a defect which cannot be remedied), the removal of that mortgage could not be allowed.-- Despite the fact that the removal of the mortgage was not allowed, there was nothing to prevent registration of the judgment rendering the sale and purchase transaction null and void, although the abovementioned mortgage guarantee would subsist.

## *2. Court decisions on the recognition and classification of claims*

This section contains a summary of several court decisions dealing primarily with the recognition and classification of claims in insolvency proceedings. The topics covered include the termination of swap agreements in the interests of the insolvency proceeding and the classification of the resulting claims; development charges imposed by a development apportionment entity and the classification of the resulting claims; and the determination of lawyers' fees and the nature of claims in respect of their professional services.

*2.1 Supreme Court*

2.1.1 Judgment dated July 8, 2014 rendered by Chamber One of the Supreme Court

Articles 87.3 and 87.5 LC.-- Classification of a claim in respect of a payment guarantee provided by the insolvent party as security for the not yet due claim of the principal debtor.—Guarantor's liability secondary to that of the principal debtor under article 1822 Civil Code. Although it had been agreed that the payment guarantee was to be joint and several, with a waiver of the benefits of order, discussion and division, it continued to be of a secondary; payment could only be sought against the guarantor, if the principal debtor had defaulted.-- Since the claim against the principal debtor was not payable as it had not yet fallen due, the condition requiring default by the principal debtor, which would have enabled the creditor to claim against the guarantor, had not been met. Consequently, the lender's claim against the joint and several guarantor in the insolvency proceeding must be admitted as a contingent insolvency claim under article 87.3 LC.

2.1.2 Judgment dated July 10, 2014 rendered by Chamber One of the Supreme Court

Articles 61.2 and 84.2 LC and article 16 RDL 5/2005.-- Termination of interest rate swap agreements in the interests of the insolvency proceeding and classification of the resulting claims.-- The lower court held that the swap agreement should be clawed back in the interests of the insolvency proceeding pursuant to article 61.2 LC and that the status of post-insolvency order claims should be conferred on the rights of the financial institutions to the refunds and indemnification deriving from that termination (article 84.2.6 LC).-- On appeal, the court altered the classification of the claims to pre-insolvency order claims under article 16.2 RDL 5/2005.-- Cassation appeal: upheld.-- The rule applied by the court on appeal in order to alter the assessment implemented article 62.4 LC, in relation to termination after the insolvency order. That article does not apply to this case, however, because it provides that the determining factor is whether the breach took place before or after the insolvency order, which is irrelevant where termination has been found to be in the interests of the insolvency.-- The Chamber reversed the judgment under appeal and found the classification to be a post-insolvency order claim.-- DISSENTING OPINION (by Rafael Saraza Jimena, to which Ignacio Sancho Gargallo subscribed).-- The swap is a single financial transaction, notwithstanding the fact that periodical and successive payments may take place over time. If only one financial transaction was carried out, even though it may have been entered into in the context of a financial transactions framework agreement (*contrato marco de operaciones financieras* or "CMOF"), article 16 RDL 5/2005 does not apply.-- The swap does not give rise to reciprocal obligations for both contracting parties, but rather obligations for one party alone in each scheduled payment.-- If the obligation deriving from the early maturity and payment of the swap (occurring after the insolvency order) is the responsibility of the insolvent party, the method to classify it as a post-or pre- insolvency order claim must be the same as the rule which has to be used to classify any claim which may have arisen to the benefit of the financial institution in each of the periodical payments after the insolvency order, and therefore, article 61.2 LC, which is intended to apply to contracts with reciprocal obligations, does not apply.-- For that reason, the classification of the claim as a pre-insolvency order claim must be retained.

2.1.3 Judgment dated July 15, 2014 rendered by Chamber One of the Supreme Court

Articles 84.2 and 90.2 LC.-- Challenge to the list of creditors.-- Classification of the claim deriving from the development charges (or contributions) required by the development apportionment entity from the owners of the parcels.-- The provincial appellate court reversed the previous judgment classifying the claims in respect of contributions made before the insolvency order as specially preferred claims and claims in respect of contributions required after the insolvency order as post-insolvency order claims.-- Cassation appeal: dismissed.-- The courts have previously ruled on the priority and preferred nature of development charges payable to the development apportionment entity and have held that their priority amounts to an implicit statutory mortgage: the fact that it is not recorded at the Property Registry does not prevent it from holding the status of an implicit statutory mortgage for the purposes of the recognition of specially preferred status pursuant to article 90.2 LC.-- Although it is true that the provisional settlement of the development charges is subject to a later final settlement, those adjustments or rectifications do not determine the existence of the claim and its enforceability: accordingly, claims in respect of development charges cannot be regarded as contingent claims, as the insolvency manager had contended, since these are claims which have been identified, and are due and payable.-- The Chamber held that the contributions that had fallen due on or after the date of the insolvency order must be classified as post-insolvency order claims since, in accordance with article 84.2.10 LC, they derive from the statutory obligation to contribute to development expenses.

2.1.4 Judgment dated July 18, 2014 rendered by Chamber One of the Supreme Court

Article 84.2.2 LC.-- Determination of the fees of the lawyer of the insolvent party for his involvement in the insolvency petition and insolvency order, as well as for legal representation during the proceeding.-- After the insolvency order, the fee agreement reached between the lawyer and the insolvent party cannot be relied on as against the insolvency manager, which will have to decide which professional services are paid as a post-insolvency order claim and in what amount. If the lawyer is not in agreement with the opinion of the insolvency manager and brings an ancillary proceeding, the insolvency court will not be bound by that fee agreement either.-- The payment of excessive fees for the preparation and filing of the insolvency petition may be subject to an application for clawback if such payment is considered to be detrimental to the assets available to creditors, which will require the fee agreement to be challenged, even if payment is in line with that agreement.-- Claims for legal representation during the proceeding will be paid in the amount deemed appropriate and proportionate, without it being necessary to challenge the fee agreement.

2.1.5 Judgment dated July 21, 2014 rendered by Chamber One of the Supreme Court

Article 84.2.2 LC.-- Scope of a post-insolvency order claim in respect of judicial costs and expenses incurred as a result of the petition and order in a mandatory insolvency proceeding.-- Both the insolvency court and the provincial appellate court agree that the fees of the lawyer of the creditor who petitioned for the insolvency qualified as a post-insolvency order claim, but only in respect of the services related to the insolvency petition and insolvency order, not to any subsequent steps taken.-- Cassation appeal: dismissed.-- The appellant submitted that the quantification of the fee note of the lawyer of the petitioning creditor must be based on the fee standards drawn up by the relevant Bar Association and also argued in favor of a broad interpretation of article 84.2.2 LC to the effect of covering the costs and expenses relating to the common phase.—Restricted nature of post-insolvency order claims: the current wording of article 84.2.2 LC replaces the word "incurred" with "necessary", which reinforces the idea of charging to the assets in the insolvency proceeding only the judicial costs and expenses necessary for the insolvency petition and insolvency order.—Where the insolvency petitioner is a creditor, a claim for costs against the insolvent party will only arise if, as a consequence of the insolvent party's objection to the insolvency order, the court has made an award of costs.-- Quantification of the fees of the lawyer of the petitioning creditor in the absence of an award of costs: if the fees are to be paid out of the assets available to creditors, any possible agreement between the client and the lawyer will not bind the interests of the insolvency proceeding: in order to quantify those fees, the guidelines of the relevant Bar Association will not be binding.-- The standards for the quantification of the fees will be in line with the complexity of the work, the actual workload and the prevailing circumstances.

## *3. Court decisions on the assessment of the insolvency*

This section contains a summary of the most important court decisions on the assessment of the insolvency and will examine the different cases of presumptions of fault under the law such as those relating to delay in petitioning for insolvency, the existence of material accounting irregularities, fraudulent outflows of assets as a result of the improper operation of the cash pooling system and lack of cooperation with the insolvency management.

*3.1 Commercial Courts*

3.1.1 Judgment dated June 9, 2014 rendered by Granada Commercial Court No. 1

Articles 164 and 165 LC.-- Assessment of the insolvency as fortuitous.-- In its assessment report, the insolvency manager claimed that the grounds set out in article 164.2 existed and, in particular, alleged a series of material accounting irregularities, the simulation of a fictitious net worth situation and dealings in assets by the insolvent party with a view to defrauding creditors, as well as the presumption under article 165.1 LC (delay in petitioning for insolvency).--Dismissed: For there to be a material accounting irregularity, three requirements must be met: (i) there must be a material accounting irregularity, either quantitatively or qualitatively significant, or both; (ii) there must be willful misconduct or serious negligence, whereby serious negligence cannot involve a breach of the director's duties nor can that liability exist where the irregularity is the result of a breach of the director's duty of surveillance involving a simple error or a scenario falling outside the director's control, due to a third party's error (for example, when committed by the person who actually performed the work), although the error may be a one-off occurrence but requires correction; and (iii) the irregularity must be material.-- Failure to legalize the journal and inventories and financial statements book: does not amount to a material irregularity and the insolvency manger did not claim absence of cooperation by the debtor in the supply of this type of information to the insolvency manager.-- With respect to the omission of information in the notes to financial statements regarding accounting changes, estimates and accounting errors, as well as the failure to file and itemize inter-company transactions in the separate financial statements, the court held that these were not flagged up in the insolvency manager's proposed assessment, nor was any indication given of the importance of such information and omission.-- Failure to file the financial statements: what the Insolvency Law penalizes is the late filing of the financial statements, but this ground must exist from the insolvency order and going "backwards in time", in other words in the previous three fiscal years: the specific reason for lateness with respect to the filing period in the year when the insolvency order is made may be the insolvency order itself.-- No simulation of a fictitious net worth situation: this requires an intentional element with a specific motive which was not proven.-- Dealings in assets with a view to defrauding creditors: requires the element of fraud, which implies knowledge of the fact that detriment is being caused.-- Delay in filing for insolvency: the determining factor for assessing whether this ground exists is technical insolvency, not an equity imbalance or the existence of the ground for dissolution due to aggravated losses: the insolvency manager did not adduce sufficient evidence to demonstrate that the company was technically insolvent and that the petition for formal insolvency was delayed.-- The court dismissed the application for assessment as it did not contain a sufficient evidential basis for the allegations and claims referred to in the assessment report.--Other rulings with a procedural scope: (a) nature of the insolvency manager's proposed assessment: this is an expert document of a commercial nature which sets out the legal, economic/financial and net worth position of the insolvent party; (b) duty to produce documents: for the purposes of preparing the proposed assessment by the insolvency manager, the debtor must cooperate: the consequences of failing to produce documents due to the debtor's refusal to do so are set out in the procedural legislation governing this kind of conduct (article 329 of the Civil Procedure Law).

3.1.2 Judgment dated September 16, 2014 rendered by Barcelona Commercial Court No. 10

Articles 164, 165 and 172 LC.-- Assessment of the insolvency ("Spanair case").-- Status of "*de facto* director" of two companies both belonging to the autonomous community government of Cataluña, companies which were members of the main shareholder of the insolvent company.-- The status of *de facto* director was apparent in the existence of very frequent periodical meetings, the constant investment of capital in the insolvent party, monitoring how that investment was used and leading negotiations for the entry of a new active member.-- Delay in filing for insolvency: airport taxes are due and payable as soon as they are assessed by the authorities, although application can be made for their deferral and division into installments: the position of technical insolvency came to light on June 30 , 2011, the date on which the company was informed that the applications for deferral filed with the State Tax Agency had been refused. At the same time, there were financial aggregates evidencing the general cessation in payment of the company's obligations as and when they fell due, such as the high percentage of default on due and payable debt (76%) or the sharp increase in negative working capital: for the presumption of fault under article 165 LC to apply, it is not necessary to demonstrate that the conduct it contemplates (in this case, delay in filing for an insolvency order) caused or aggravated the technical insolvency.-- In order to determine whether the provision of fresh money to the insolvent party avoided the position of technical insolvency and its aggravation, the use made of those funds must be taken into account: the court held that the funds were used to pay salaries, social security contributions, and financial lease agreements for aircraft and fuel, but were not used to pay other debts such as those owed to suppliers, or in respect of loans and tax liabilities.-- In the court's opinion, because the pre-insolvency order claims continued to increase, technical insolvency may be said to have been aggravated, evidenced by the increase in the debt which was due, payable and unpaid since the position of technical insolvency began in the period until the petition for formal insolvency was lodged.-- The steps taken to secure financing and negotiate with possible shareholder investors mitigated but did not lift liability for aggravation of the insolvency.-- The order for disqualification may be regarded as one of "public policy", being a necessary and unavoidable consequence of the assessment of the insolvency as fault-based.-- The court also ordered for the insolvency shortfall be covered in the amount of €10.8 million, representing the due, payable and unpaid debt existing between December 31, 2011, the date on which the chance of entry of an active member disappeared, and the date of the insolvency petition.

3.1.3 Judgment dated September 30, 2014 rendered by Madrid Commercial Court No. 6

Articles 164.2.1 and 165.1 LC.-- Assessment of the insolvency ("Afinsa case").-- Assessment of the insolvency as fault-based due to the existence of accounting irregularities and breach of the duty to petition for insolvency.-- Material accounting irregularities: the insolvent party (i) did not recognize in liabilities the economic commitments it had entered into with its customers for the future implementation of sale instructions in relation to lots of stamps; and (ii) recorded acquired stamps under assets in its accounts, at amounts significantly higher than their market values. Given the significant number of unrecorded accounting entries, the amounts of those entries, the persons affected and the vast repurchase undertakings, the accounting irregularities had to be classified as material and serious.-- Breach of the duty to petition for insolvency: the situation of thin capitalization or negative net-worth is strong prima facie evidence of technical insolvency: that evidence must be evaluated by reference to the actual economic/net-worth position of the debtor, irrespective of whether or not the accounting records reflect the accumulated losses. The debtor's accounting records showed that it was

technically insolvent before the petition for formal insolvency. Accordingly, the failure to petition for insolvency represented a careless neglect of the basic duties of the board of directors of the insolvent party, determining aggravation of its technical insolvency.-- Parties to whom the finding of fault-based insolvency applies: the effects of this finding had to be applied to the three persons who served as director in the two years preceding the insolvency order, because the court held that the acts determining liability were directly the tasks of the managing body.—Outcome of the finding of fault-based insolvency: (i) disqualification of the three directors from managing other people's assets for fifteen years and from representing anyone in the same period of time; (ii) forfeiture of any rights they might have had as creditors holding pre- or post-insolvency order claims; and (iii) order to return any assets and rights they may have improperly obtained from the insolvent company.-- Liability for the shortfall in an insolvency proceeding: the order made against the directors requiring them to cover the shortfall in the insolvency proceeding is not an automatic consequence of a fault-based insolvency proceeding, but requires an "additional ground", based on especially reprehensible conduct by the directors, which is the case here. The evaluation of liability for the shortfall is subject to broad discretion by the courts, with respect to both the handing down of the order and the setting of its quantitative scope, and account must be taken of the objective seriousness of the conduct as well as the degree of involvement of the parties subject to the order in the acts giving rise to the finding that the insolvency is fault-based. In the described case, each of the three directors were held severally liable for 1/3 of the shortfall in the insolvency proceeding (unpaid pre- and post-insolvency order claims), which was reasonably valued at €1,823 million.

3.1.4 Judgment dated October 6, 2014 rendered by Madrid Commercial Court No. 12

Articles 164 and 165 LC.-- Insolvency assessed as fault-based ("Viajes Crisol case").-- The court found liability for fault for the company directors, a deceased director (against his estate) and the *de facto* director.--Material accounting irregularity: the absence of allowances recorded for the accounts receivable from group companies was a material accounting irregularity, by reason of the group's single decision-making and cash pooling arrangements, facts leading to the conclusion of voluntary omission of allowance for inter-company receivables.--Serious inaccuracy in the documentation: the inventory submitted alongside the insolvency petition contained clear variances from the asset valuations set out in the report of the insolvency manager.-- Fraudulent outflows of the debtor's assets: the cash pooling system was not properly operated, as it was not used to provide the group companies with the necessary funds but was instead used to supply companies involved in different business activities linked to the company owning the head of the group.-- Simulation of a fictitious net worth position: despite a breach of the true and fair view principle for the financial statements, the insolvent party continued with its operations, apparently unaffected by its parent company's real situation, and even continued to receive prepayments shortly before petitioning for insolvency and to provide guarantees to group companies.-- Lack of cooperation with the insolvency manager: delay in terminating leases on the premises where the company conducted its business, IT service agreements or employment contracts, acts which aggravated the technical insolvency.-- Delay in petitioning for insolvency: the delay caused a sharp decline in the insolvent party's business which aggravated its technical insolvency, although the truth of the matter is the lack of cash also contributed to that position.-- Orders arising from the assessment section: article 172 bis: it is necessary to determine the individual conduct of the persons affected by the assessment which led to the finding of fault.-- The *de facto* director is not liable for the material accounting irregularities or the fraudulent outflow of the debtor's assets occurring before the date on which he commenced his *de facto*

directorship.-- Effects of assessment of fault: (i) disqualification from managing the assets of others for 15 years; (ii) forfeiture of rights as creditors in insolvency proceedings; (iii) joint and several liability for 40% of the shortfall in the insolvency proceeding ordered against all of the directors, whilst in the case of the *de iure* director and the estate of the deceased director, the joint and several liability imposed amounted to 100% of the shortfall in the insolvency proceeding.

## *4. Other court decisions*

### *4.1 Supreme Court*

#### 4.1.1 Judgment dated June 18, 2014 rendered by Chamber One of the Supreme Court

Articles 49, 61 and 62 LC.-- Enforcement of a pledge established by a guarantor as a result of a breach of the principal obligation by the insolvent debtor, while an insolvency proceeding remained to be performed on the debtor.-- The lower court judgments dismissed the application, which sought to have an order made against the financial institution requiring it to return the balance of the pledgor's demand deposit obtained through enforcement.-- Cassation appeal: dismissed.—In a payment guarantee, one party undertakes to pay or perform in the place of a third party, if that third party fails to do so.-- Although the appellant argued that the insolvent party was not able to default on payment of the interest, because the interest was not payable by it, it is one issue whether the obligations cannot be enforced against the insolvent party, the principal debtor, but it is quite a another issue whether once the interest on the loan has fallen due, and since a security interest is involved in accordance with article 59 LC, that interest should not be paid by the pledger/payment guarantor, up to the limit of the established pledge.-- Articles 61 and 62 LC, invoked by the appellant, are not applicable in this case, since the secured loan is a unilateral contract and those articles relate to contracts with reciprocal obligations.-- The Chamber held that a creditor who has been provided with a security interest by a guarantor may, in the event of breach of the principal obligation by the insolvent debtor, enforce that security interest on the terms agreed, up to the limit of the security interest.

#### 4.1.2 Judgment dated July 2, 2014 rendered by Chamber One of the Supreme Court

Articles 84 and 176 bis 2.2 LC.-- Insolvency proceeding ended as a result of insufficient assets available to pay the post-insolvency order claims.-- At issue was whether the maximum limit set out in article 176 bis 2.2 LC is shared by claims for salaries and severance. The lower court considered both to be part of the same item. This was later overturned by the provincial appellate court, which concluded that the rules required a distinction to be drawn between "salaries" outstanding for payment and "severance" for contractual termination.-- Cassation appeal: Dismissed.-- Since the origin and purpose of both employment claims are different, treating them as one would have adverse consequences for workers.-- Article 84.2 LC supports the idea that the claim for severance for contractual termination deserves a specific mention, separate from the reference made to salaries.-- The Chamber held that claims for salaries and severance to which reference is made in article 176 bis 2.2 LC must be regarded as two separate and independent categories, and the quantitative limit for their payment should not be applied as if they were a single claim. Accordingly, the limit must be applied to each category separately.

4.1.3 Judgment dated September 4, 2014 rendered by Chamber One of the Supreme Court

Article 140 LC.-- Nonperformance of the arrangement with creditors.-- The lower court's judgment held that it had not been proven that all of the claims due and payable according to the arrangement had been paid and found that the arrangement had been breached and should be terminated. That decision was confirmed by the provincial appellate court.-- Cassation appeal: dismissed.-- The appellant pleaded that, although – upon expiry of the first deadline – the first past-due deferral of the claims of three creditors had not been paid, these claims were subsequently paid.-- Under article 140 LC, the nonpayment of a due and payable claim is sufficient to lawfully authorize termination of the arrangement, although the breach must continue to exist when the action for termination is brought.— Should there had been a mere delay on the payment, but such payment may had been satisfied before filing the lawsuit, the creditor would lack standing to request the termination.-- In this case, when the action for termination was brought, the claims of the creditors who petitioned for insolvency were outstanding for payment in the proportion relating to the first deferral, with the result that their subsequent payment did not reduce the force of the action or convert the breach into a simple delay.

*4.2 Provincial Appellate Courts*

4.2.1 Decision dated July 29, 2014 rendered by Pontevedra Provincial Appellate Court

Article 8 of Law 10/2012 ("Fees Law") and articles 172 and 172 bis LC.-- Finding of fault-based insolvency.-- Appeal to a superior court: leave to appeal disallowed due to failure to pay court fees.-- Appeal against disallowance of leave to appeal: upheld.-- It may be inferred from the statutory exemptions and rebates relating to payment of judicial fees that the legislature sought for fees not to accrue, or at least to restrict their amount in both court steps of a criminal nature as well as steps which, without being of a criminal nature, have similar effects or affect the public interest.-- In light of the foregoing, the provincial appellate court held that the assessment is not subject to payment of the fees, because: (i) the consequences deriving from an assessment of fault are similar to the sentences provided for in the Criminal Code; (ii) the comparison between some sentences in the strict sense of the term, which can be challenged without paying fees, and the penalties set out in articles 172 and 172 bis LC, highlight that the latter are more serious, from a qualitative and quantitative standpoint, than the former; and (iii) there is a public interest in the assessment section, as its goal is to impose penalties.-- Furthermore, an uncritical application of article 8 of Law 10/2012 would entail, first, a patently disproportionate fee and, second, clear discrimination depending on the side to which the appellant belongs in the court process, to the detriment of the losing party.

*4.3 Commercial Courts*

4.3.1 Decision dated July 22, 2014 rendered by Pontevedra Commercial Court No. 3

Article 139 LC.-- Application for a court declaration of performance of the arrangement with creditors.-- Requirements for the declaration of performance of the arrangement: (i) application by the debtor: must be supported by evidence of the payments and obligations accepted in the arrangement; (ii) application made available for consultation at the office of the court for 15 days: the aim is to enable creditors to make pleadings on the statement

of performance, without it being necessary for them to enter an appearance; (iii) court decision on performance: not automatic and requires an examination of the application. The application may be dismissed, either with or without prior pleadings from the creditors.-- In this case, the insolvent party did not state that it had performed the arrangement, but announced: (i) that it would perform the arrangement after the court handed down the decision on performance; and (ii) specifically, it would provide performance by providing guarantees by two credit institutions (although the terms of those guarantees were unknown).-- After stating that it could not act as a manager of the payments undertaken in the arrangement, the court accepted the method of performance offered by the debtor, as it was not expressly rejected by any of the creditors within the time limit set for that purpose: in an insolvency proceeding, in view of the high number of interests involved, the methods for giving consent cannot be the same as in a bilateral contractual relationship.-- Declaration of performance of the arrangement: the court stated that although that method of performance did not fit within the originally scheduled payment arrangement, it was presented to creditors as an alternative providing a higher guarantee of performance, without causing detriment to their rights since, if the guarantees were ultimately not given in the envisaged manner, the creditors would still be able to bring complaints in respect of nonperformance of the arrangement, and therefore, there is nothing which renders the agreed performance irrevocable.

4.3.2 Judgment dated September 8, 2014 rendered by Barcelona Commercial Court No. 9

Articles 97 bis and 155.4 LC.-- Amendment of the definitive wording.—The giving in payment of several properties owned by the insolvent party to the benefit of banks holding claims secured by a first-priority mortgage, ordering the removal of subsequent charges and encumbrances, including a second-priority mortgage taken out to the benefit of the State Tax Agency (*Agencia Estatal de la Administración Tributaria* or "AEAT"). AEAT applied for amendment of the definitive wording and asked for the remainder of its unpaid claim charged against the mortgage to be classified as a generally preferred claim (50%) and as an unsecured claim (50%).-- Dismissed: interpretation of article 155.4 LC: the unpaid tax claim not satisfied against the encumbered asset cannot be re-classified by the insolvency manager in order to confer on it the priority to which it would have been entitled had the collateral never existed: the classification of the tax claim as a specially preferred claim occurred and was finalized in the insolvency manager's report, without being challenged by AEAT, and therefore AEAT could not later request its reclassification as a generally preferred claim.-- The tax claim could be given preferred status twice: it could not be given specially preferred status and generally preferred status either simultaneously or cumulatively over time.-- The commercial court dismissed the ancillary claim brought by AEAT and confirmed the amendment of the definitive wording on the terms proposed by the insolvency manager, by conferring the status of unsecured claim on the whole of the remaining tax claim.

*4.4 Courts of First Instance*

4.4.1 Decision dated July 17, 2014 rendered by Lugo Court of First Instance No. 2 (Commercial)

Article 148 LC.-- Liquidation with a structural modification transaction: Partial spin-off of a line of business, with the *en bloc* transfer to a newly-formed company of the assets and liabilities used in the leasing line of business, including the workers assigned to that line.-- The liquidation plan drawn up by the insolvency manager identified the assets and

liabilities to be transferred and provided that the spin-off would have effects for accounting and economic purposes from its registration at the Commercial Registry.-- The liquidation plan set out that the additional rules on liquidation were secondary, in all cases, and that any other method of realizing assets and settling liabilities expressly set out in the plan would take precedence.-- The court approved the liquidation plan without amendment and concluded that the proposed spin-off of the leasing line of business for its subsequent disposal was entirely feasible.

*4.5 Directorate-General of Registers and the Notarial Profession*

4.5.1 Decision of the Directorate-General of Registers and the Notarial Profession dated May 23, 2014

Article 149 LC.-- Registration of a deed awarding a production unit as there was no record that the award order was final.-- The registrar has the power to refuse or authorize the registration of court decisions after examining the requirements of finality and enforceability.-- The noting of definitive entries at the Property Registry, such as registrations or removals, ordered pursuant to a judicial document, can only be carried out when that document is final. As regards court decisions resulting in the transfer of a registered title, the law requires such decisions to be final, on account of the need to prevent the appearance of a holder protected by the principle of authenticity of information recorded at public registries under article 34 of the Mortgage Law.-- This standard also applies to decisions the enforcement of which is made official by recording the relevant award or title transfer in a deed. Consequently, since an appeal lies against the decision awarding the production unit which includes the property in question, the transfer cannot be registered unless it can first be proven that the decision is final.

4.5.2 Decision of the Directorate-General of Registers and the Notarial Profession dated July 1, 2014

Article 8.4 LC.-- Noting of a preservation measure adopted against an insolvent party. At issue was whether it was possible to provisionally note a claim bringing action for contractual termination, ordered by a court of first instance, on a property owned by an insolvent company, or whether the order had to be issued by the commercial court handling the insolvency proceeding.-- The special rule set out in article 8.4 LC should be applied, which stipulates that the insolvency court has exclusive jurisdiction – to the exclusion of all others – over all preservation measures (such as a provisional noting of a claim) affecting the assets of the insolvent party. Since this measure is not one of the measures excluded by this provision, the noting of the entry requested should be refused, since the order was handed down by a court which did not have jurisdiction for that purpose.-- It could not be argued that the claim in respect of which the provisional noting was sought was filed before the insolvency order, because the Registry was already aware of the technical insolvency of the company; the registrar must take the existence of the insolvency proceeding into account when assessing the document.

4.5.3 Decision of the Directorate-General of Registers and the Notarial Profession dated July 22, 2014

Articles 55 and 56 LC.-- Registration of an award of assets in a mortgage foreclosure proceeding where no payment has been claimed or demanded from the non-mortgagor bankrupt debtor.-- Article 132.1 of the Mortgage Law and article 685 of the Civil Procedure Law require that, in a mortgage foreclosure proceeding, payment must be claimed and demanded from the debtor in addition to the non-debtor mortgagor. Among other reasons, the act of claiming and demanding payment from the debtor enables the foreclosure proceeding to continue against him in the event that the proceeds of the disposal of the mortgaged property are not sufficient to cover the debt.-- For registration purposes, the failure to formally demand payment from the non-mortgagor debtor is able to be assessed by the registrar. If this requirement is not met, the defect will be flagged up and the deed will not be registered.-- In the present case, the absence of notice to the non-mortgagor debtor is a defect which may be remedied, because the non-mortgagor debtor is bankrupt, which prevents individual enforcement proceedings against it. In order to register the award of the foreclosed assets, evidence must be produced of the bankruptcy of the non-mortgagor debtor and of the notice of the steps taken to the trustee in bankruptcy.

4.5.4 Decision of the Directorate-General of Registers and the Notarial Profession dated July 24, 2014

Article 48 LC.-- Revocation of a power of attorney granted by an insolvent company without supervision by its insolvency manager.-- The insolvency proceeding on the granting company does not have a neutral effect on power of attorney relationships; those powers are subject to the same rules on limitations as those which apply to the body from which the powers of attorney derive.-- The insolvency manager has an obligation to ascertain and supervise powers of attorney granted by the insolvent company regardless of whether they are in force.-- The body with authority to represent the company cannot exercise the powers inherent in that authority in order to grant representative powers to third parties, or to revoke such powers, without supervision by the insolvency manager.

4.5.5 Decision of the Directorate-General of Registers and the Notarial Profession dated September 5, 2014

Article 149.3 and 155.4 LC.-- Registration of a court decision approving a liquidation plan ordering the removal of all charges, encumbrances, impediments, personal guarantees and security interests, both before and after the insolvency proceeding, which affect the assets to be liquidated, especially any charges on immoveable property.-- Registration was refused for the following reasons: (i) it was not evidenced that the order had been notified to the holders of the attachments ordered on the property: in order for the insolvency court to be able to remove attachments ordered on a property owned by the insolvent party, it must be proven that the affected creditors had first been heard; however, if removal of the attachments is sought in the liquidation phase, the requirement that the affected creditor must be heard will be replaced with notification to the creditor, and this did not occur in the present case; (ii) the removal of the mortgages cannot take place before the sale of the mortgaged asset; furthermore, the disposal of the mortgaged assets must satisfy the requirements in article 155.4 LC; (iii) no evidence was produced of the measures taken in relation to payment of the specially preferred claims; (iv) since the order approving the liquidation plan was not yet final, it was not able to be registered.

## IV. Awards and recognition

**"Best Lawyers in Spain 2015"**

The Best Lawyers guide recently published its annual list of the best lawyers in the various practice areas of corporate law. Out of the selected lawyers, over a thousand in total, 247 were from Garrigues. We thus managed, once again, to be the most featured law firm on this coveted list and did even better than the 211 recommendations we achieved last year.

This year, fourteen professionals from our Restructuring and Insolvency Department appeared on the list of the best insolvency and reorganization law lawyers in Spain.

## V. Garrigues publications

**"La oportunidad de comprar una empresa en concurso"** ("The opportunity to buy an enterprise in an insolvency proceeding"), [Burillo], Diario de Navarra, August 4, 2014.

**"Protección del tejido empresarial frente al concurso"** ("Protection of the fabric of business against insolvency proceedings"), [Burillo], Diario de Navarra, September 27, 2014.

**"Venta de unidades productivas en el concurso** ("Sale of production units in insolvency proceedings), [Almoguera], Diario Sur, September 28, 2014.

**"De nuevo, reforma concursal"** ("Another helping of insolvency law reform"), [González Pajuelo], La Verdad de Murcia, October 2, 2014.

**"¿Es posible comprar empresas en concurso?"** ("Is it possible to purchase companies immersed in an insolvency proceedings?"), [Morata], Economía 3, November 18, 2014.

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