GARRIGUES updates
restructuring & insolvency

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1. NEW LEGISLATION

1.1 Royal Decree-Law 6/2012, of March 9, 2012, on urgent measures to protect low income mortgage debtors

Royal Decree-Law 6/2012 contains a package of measures designed to make it simpler for individuals experiencing repayment difficulties to restructure their mortgage debts, and provides mechanisms to make foreclosure proceedings more flexible.

For more information, see our monograph.

1.2 Royal Decree-Law 7/2012, of March 9, 2010, creating the Fund for financing payments to suppliers

Royal Decree-Law 7/2012 seeks to create the required instrument to implement a plan for payments to suppliers by local authorities to ensure the success of the mechanism initially created by Royal Decree-Law 4/2012, of February 24, 2012.

For more information, see our monograph available in Spanish.

2. CASE COMMENTARIES

JUDGMENT of Chamber I of the Supreme Court dated January 16, 2012. Art. 164.2.1 LC. Assessment of the insolvency as fault-based. Material accounting irregularity consisting in failure to record in the financial statements the existence of a personal guarantee that the insolvent party had provided for its Japanese subsidiary.-- The financial statements refer to different dates and periods but the uniformity rule which safeguards reasonable continuity in accounting records requires that sufficient information must be provided.-- Difference between accounting error and accounting irregularity: the latter requires intention to conceal. Appeal dismissed.

Commentary:

After the assessment section was opened, the insolvency manager submitted a report on the factors leading to the conclusion that the insolvency should be regarded as "fault-based", which were essentially as follows:

(a) Failure to revoke a guarantee provided by the insolvent debtor for another party which, on the date of the agreement, was its subsidiary in Japan, to a creditor of that company, despite the fact that most of the shares making up the Japanese subsidiary's capital stock came into the possession of third parties on November 17, 2003.

(b) A material irregularity in the accounts of the insolvent party due to failure to record the guarantee in the financial statements.

(c) Breach by the insolvent company of the duty to petition for insolvency by the stipulated deadline.

The insolvency manager sought a finding that the fault affected one of the three members of the board of directors and his disqualification for two years.

In its judgment of April 11, 2008, Madrid Commercial Court No. 7 held that the insolvency was fault-based due to the material irregularity in the accounting records and a breach of the obligation to petition for insolvency by the stipulated deadline. Furthermore, it found that the fault affected the board member and disqualified him for 3 years.

The insolvent company and the board member concerned appealed against the judgment. In its judgment of April 17, 2009, Madrid Provincial Appellate Court partly upheld the appeal, and only overturned the finding of breach of the obligation to petition for insolvency by the stipulated deadline, and confirmed the other findings (in particular, the finding that a material accounting irregularity had been committed). The board member affected by the assessment filed a cassation appeal and a special appeal against procedural infringements at Chamber I of the Supreme Court.

With respect to the material accounting irregularity, in the first ground for the cassation appeal, the appellant argued that an "error" was quite different from an "irregularity", since the former, unlike the latter, did not require there to be any intention to conceal. The Supreme Court held that the assessment of an insolvency as fault-based on the ground of a material accounting irregularity did not require the irregularity to be the cause of or to have aggravated the insolvency. The court clarified that the act alone of engaging in the positive or negative conduct set forth in the six paragraphs of article 164.2 LC establishes that the insolvency is fault-based. Thus, with respect to the issue of material accounting irregularities, the actor does not need to be aware of the scope and legal significance of his act or omission, nor must the outcome of such conduct be intentional (although the Supreme Court considered it proven that the omission was a conscious and voluntary omission, since the signatory of the guarantee was none other than the appellant, who concealed the fact from his fellow board members).

In his second ground of appeal, the appellant argued that the finding that there had been an accounting irregularity with respect to different fiscal years involved a misinterpretation of article 164.2 LC. In this regard, the Supreme Court held that the uniformity rule, which safeguards reasonable continuity in accounting records, requires that sufficient information must be provided in subsequent fiscal years on the validity of a guarantee entered into with

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a third party in a previous fiscal year. The court therefore dismissed the appellant's second ground.

Lastly, in his third ground of appeal, the appellant claimed that the accounting irregularity attributed to him did not warrant the classification of "material" as the insolvent party was obliged to prepare consolidated financial accounts and the debt owed to the secured creditor already appeared in the accounting records of the Japanese subsidiary. In this connection, the Supreme Court took the view that in order for an irregularity to be regarded as material, it must affect an item of information that is material for understanding the "the net worth or financial position" of the insolvent company, with the result that if such information was absent from the Spanish company's financial statements, it is possible to talk about a material irregularity.

Consequently, the Supreme Court dismissed the special appeal against procedural infringements and the cassation appeal, and upheld the judgment of Madrid Provincial Appellate court in its entirety.

3. HEADNOTES

Constitutional Court

JUDGMENT dated February 13, 2012 rendered by the Constitutional Court

Article 168 LC and Article 24 of the Spanish Constitution. Infringement of the right to an effective legal remedy: A commercial court infringed the right to an effective legal remedy when it set aside the submissions phase in the assessment section for interested parties other than the debtor and those affected by the assessment. In the Constitutional Court's view, the arguments and reasons advanced by the judge in the insolvency proceeding to prevent the insolvent party's employees from filing submissions on the grounds for the assessment of fault had no legal basis and entailed an arbitrary interpretation of the law, which violated their right of access to the court. The Constitutional Court ordered that the proceedings be reinstated so as to allow the appellants to file submissions, which the judge had wrongfully dismissed.

Supreme Court

JUDGMENT dated January 10, 2012 rendered by Chamber I of the Supreme Court

Art. 84.1 LC: Nature of a claim held by the State Tax Agency (AEAT) arising from the issue of correcting VAT invoices. The AEAT argued that the issuance of a correcting invoice by the creditor, who had not paid VAT on an insolvency claim, entailed an extinctive novation (not simply an amendment novation due to a change of the identity of the creditor). The Supreme Court concluded that the correction of VAT on an invoice documenting an insolvency claim does not give rise to an obligation after the insolvency order: under article 21.1 of the General Taxation Law, VAT becomes chargeable when the taxable event is deemed to have occurred (when the principal tax obligation arises), and that date on which it becomes chargeable determines the primary circumstances that shape the tax obligation. The Supreme Court clarified that if the tax becomes chargeable prior to the insolvency order, it cannot be regarded as a post-insolvency order claim.

JUDGMENT dated February 28, 2012 rendered by Chamber I of the Supreme Court

Arts. 878.2 and 949 of the Commercial Code. Claim for liability against trustees in bankruptcy for refusing to sell shares owned by the bankrupt trader. The Supreme Court dismissed the cassation appeal as there was no proof that the potential purchaser of the shares would have maintained its offer if it had known that the shares were subject to an attachment and the corporate resolution at the root of the transaction had been challenged. The offer submitted to the trustees in bankruptcy entailed a deferred payment of the full price for the shares (which, in any event, prevented any immediate lifting of the attachment, since the debt giving rise to the attachment more than quadrupled the sale price of the shares). The Supreme Court held that the trustees in bankruptcy were not liable as the price of the shares was higher than the initial offer price and stated that in order to avoid liability, trustees must not, under any circumstances, accept any offer whatsoever regardless of the price and payment term and, instead, should only accept offers that are profitable.

JUDGMENT dated February 22, 2012 rendered by Chamber I of the Supreme Court

Art. 154.3 LC: Order for payment of post-insolvency order claims. Several post-insolvency order claims and insufficient assets.-- Payment of post-insolvency order claims by the insolvency managers without observing the chronological order of payment.-- Issue raised and decided on prior to the reform of the Insolvency Law implemented by Law 38/2011 (which, due to transitional provisions and legal certainty, prevents the new provisions of art. 176 bis from applying, pursuant to which, in the event of insufficient assets, a specific order of payment is established whereby the assets are distributed "on a pro rata basis for each type of claim", except for "claims that are essential to completion of the liquidation").-- The Supreme Court found that the pre-reform provisions applied, under which post-insolvency order claims must be paid in accordance with their respective due dates, regardless of their nature and the stage of the insolvency proceeding. Consequently, the Supreme Court upheld the appeal filed by the Social Security General Treasury and held that its post-insolvency order claims had preference as the due dates fell before those of the claims than had been wrongfully paid by the insolvency managers.

DECISION dated March 16, 2012 rendered by Chamber I of the Supreme Court

Arts. 8 and 64 LC. Conflict of jurisdiction between a labor court and a commercial court as to which had jurisdiction to hear claims for unjustified dismissal filed by three workers who had not been included in a collective layoff procedure.-- The commercial courts have jurisdiction in relation to the termination of employment exclusively in cases of collective terminations, modifications or temporary interruptions of employment, rather than individual cases.-- Exception: article 64 LC provides that in the context of an insolvency proceeding, individual actions for termination brought under article 50 of the Workers' Statute (*Estatuto de los Trabajadores* or ET) are regarded as collective actions and, therefore, also fall under the jurisdiction of the commercial courts (under article 50 ET, a worker may apply for the termination of their employment relationship due to a material modification to their working conditions, delays or failures or make salary payments or any other serious breach by the employer).-- The Supreme Court held that the labor court had jurisdiction to hear the individual actions for termination of employment as the termination

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was not claimed to be on the basis of any of the grounds set forth in article 50 ET and was instead an action for unjustified dismissal.

Provincial Appellate Courts

JUDGMENT dated October 24, 2011 rendered by Girona Provincial Appellate Court

Art. 78.3 LC: Right of the insolvent debtor's spouse to acquire an indeterminate half of the insolvent debtor's assets by paying half of their value to the assets available to creditors.-- The appellants had each owned an indeterminate half of properties subject to a survivorship agreement since 1997. A voluntary insolvency order was made against the husband and the insolvency managers applied for authorization from the court so that the insolvent debtor could sell his indeterminate half to his spouse. The application was refused by the commercial court as it disagreed with the agreed sale price.-- The provincial appellate court held that the value of the married couple's usual place of residence, where one of the spouses was insolvent, would be the purchase price updated in line with the variations in the CPI and not the "market value". This exception is rooted in the fact of the interests of the family group and of the spouse of the insolvent debtor taking priority over the interests of the creditors in the insolvency proceeding.-- The provincial appellate court upheld the married couple's appeal, confirmed the notarized sale and purchase transaction, and ordered that the indeterminate half of the assets owned by the insolvent husband be entered on the property registry in favor of his wife.

JUDGMENT dated January 12, 2012 rendered by Córdoba Provincial Appellate Court

Arts. 87 and 89 LC. Insolvency order made against a joint and several guarantor. Treatment of a claim held by a secured creditor in the insolvency proceeding of the principal debtor. "Insolvency claim", with the assessment this entails, v. contingent claim. The court held that: (i) the security function of the guarantee entails the establishment of a new obligation relationship with its own content and the specific item to be guaranteed; (ii) the guarantor is not the debtor not in respect of the secured obligation, but in respect of his own obligation, with the result that when he pays, he is performing his own obligation and not that of the principal debtor, although by doing so he satisfies the interests of the debtor; (iii) without disputing the element of secondary liability present in a joint and several guarantee, this does not necessarily mean that a claim against a joint and several guarantor on which an insolvency order has been made must be regarded as a contingent claim, since the principle of "secondary liability of debtors" must not be confused with the principles of "secondary or joint and several liability in enforcement or in a claim", as under article 1144 of the Civil Code, in the case of a joint and several guarantee, the debt can be claimed from any of the obligors. In this regard: (a) if the secured obligation has not yet fallen due, it is clear that the principal debtor is under no obligation to pay, nor is the guarantor, and therefore only the claim against the insolvent guarantor can be regarded as a contingent claim; (b) if the principal debtor continues to perform his obligations, then no obligations whatsoever will have arisen for the guarantor and, therefore, the claim must be regarded as a contingent claim of an undetermined amount (claim subject to a "*conditio iuris*": nonpayment by the principal debtor); (c) if the principal debtor is in breach, the claim against the guarantor will be an insolvency claim, fully enforceable, with the relevant classification, since in view of the joint and several nature of the debtors' liability, the

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creditor may seek payment of the debt from the principal debtor or from the joint and several guarantor. Lastly, article 161 LC prohibits duplication in payments, as the guarantor must be regarded as if he were the principal debtor, with the status of "*in solidum*".

JUDGMENT dated January 19, 2012 rendered by Murcia Provincial Appellate Court

Arts. 86.2 and 92 LC. Insolvency proceedings. Admission of claims: The tax agency notified several insolvency claims late, and they had not been reflected on the provisional list of creditors. The insolvency managers objected to the admission of those claims as they had been notified late. The commercial court held that all claims notified late were subordinate claims, as the certificate issued by the authorities did not bind the insolvency manager or the court as to the order of priority of payment of claims or their nature. The provincial appellate court confirmed the decision of the commercial court, concluded that there had been no inconsistency by omission as the commercial court's judgment had covered the issues in dispute in full, and held that the claims were insolvency claims rather than post-insolvency order claims, classifying them as subordinate claims due to their late notification.

JUDGMENT dated February 24, 2012 rendered by León Provincial Appellate Court

Arts. 2, 164, 165 and 172 bis LC Transfer of a company with a net worth imbalance but up to date with payment of its obligations due exclusively to shareholders' personal contributions. The provincial appellate court considered that the company's technical insolvency (which it described as "latent"), existed prior to its transfer, as it was in a situation of negative equity and was only able to meet its current payments out of shareholders' contributions. A fault-based insolvency. Existence of an irrebuttable presumption of willful misconduct or gross negligence in the occurrence or aggravation of the insolvency due to breach of the duty to petition for insolvency by the stipulated deadline before the transfer. Furthermore, the provincial appellate court held that there were two irrebuttable presumptions of willful misconduct or gross negligence in the occurrence or aggravation of the insolvency: (i) a material irregularity preventing an understanding the net worth or financial position of the insolvent party due to the failure to record the depreciation of assets in the accounts; and (ii) fraudulent removal of an asset belonging to the debtor in the two years preceding the date of the insolvency order, due to the failure to pay the price obtained for the sale of machinery into the company's cash account. The court clarified that the liability of the company's directors results from their involvement in the events from which the fault arises rather than specific debt or liabilities. The provincial appellate court confirmed the order against the directors requiring them to make up part of the company's net worth deficit and not to pay specific liabilities or obligations if they had been involved or acted in their creation or recognition.

DECISION dated March 12, 2012 rendered by Madrid Provincial Appellate Court

Arts. 56 and 57 LC. Analysis of the jurisdiction of the judge in the insolvency proceeding to conduct foreclosure proceedings in respect of the insolvent party's assets. Articles 56 and 57 LC contain specific provisions on the enforcement of collateral consisting of assets used in the insolvent debtor's business, permitting a separate right of enforcement for collateral

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consisting of assets of the insolvent debtor which are not used in its business; enforcement proceedings on assets not used in the business do not, therefore, fall under the jurisdiction of the insolvency judge. If the insolvency court is to conduct enforcement proceedings in respect of a particular asset of the insolvent party, it must first be established whether the asset is used in the business activity.-- The provincial appellate court ordered that the proceedings be returned to the insolvency court in order to determine the use of the assets in question, as a preliminary step to recognizing its jurisdiction to conduct enforcement proceedings in respect of the assets.

Commercial Courts

JUDGMENT dated February 1, 2012 rendered by Barcelona Commercial Court No. 2

Art. 71 LC. Clawback action against a mortgage executed by the insolvent debtor for another company in the same group. Dismissed. The insolvency manager argued that the security provided by the insolvent debtor was detrimental, and must therefore be clawed back. The insolvency manager argued, however, that despite clawback of the mortgage, the amount provided under the mortgage, which had been drawn down in full, should not be refunded to the financial institution. The commercial court dismissed the petition to claw back the mortgage and maintained the guarantee provided to the financial institution as it considered that: (i) the law only provides for the automatic clawback of guarantees provided for preexisting obligations, but not of guarantees provided for simultaneous obligations; (ii) a partial clawback (i.e. reversing the guarantee and maintaining the secured obligation) would not be possible as, although ancillary, the guarantee was essential to underwrite the business; (iii) lastly, clawing back the guarantee would imply altering the circumstances in which the financial creditor gave its consent. The court concluded that in a case of upstream/downstream guarantees, there cannot be a reciprocal clawback of obligations which is the essential effect of a clawback action, and therefore they cannot be upheld.

JUDGMENT dated February 7, 2012 rendered by Barcelona Commercial Court No. 2

Art. 36 LC. Liability of the insolvency manager. Dismissal of action for liability brought as a result of his decision to shut down the business operations of the insolvent company and terminate the employment contracts of the whole workforce. The court held that the insolvency manager had not acted against the law or infringed his duty of diligence. The court considered that the plaintiffs had not proven that at the time of the decision to shut down the business operations and terminate the contracts it was recommendable to keep the business operations going to set in motion the sale of the production unit. The court concluded that, in the case of a company involved in an insolvency proceeding, which loses its main supplier, which does not have any funding sources, which has had its proposal for an arrangement rejected and which is heading for liquidation, it cannot be held to be proven that there was any viable alternative to the definitive shutdown of operations, and in the absence of a definite alternative way for the business to continue, the fast-track opening of a procedure for collective termination of employment contracts was the least costly option for the assets available to creditors. The court also dismissed the petition in the complaint relating to the payment by the insolvency manager to the insolvent company's lawyer of several invoices for professional fees which the workers regarded as excessive and

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unwarranted. The court concluded that the plaintiffs, who had appeared in the insolvency proceeding, had not challenged the recognition of the post-insolvency order claim of the insolvent company's lawyer or the report on the submission of accounts by the insolvency manager, and besides, the payment was protected by the law as it fulfilled the criteria of the bar association.

DECISION dated March 6, 2012 rendered by Valencia Commercial Court No. 3

Article 37 LC. Automatic removal of the insolvency manager. There was "just cause" to remove the court-appointed insolvency manager from his position where an analysis of the circumstances surrounding his actions revealed that the report submitted to assess the proposal for an arrangement filed by the debtor displayed a lack of rigor and objectivity, besides not providing even a glimmer of awareness of the company's circumstances, the remedial measures adopted to combat the crisis, or accuracy and consistency in the viability plan and payments plan. The court held that its trust had been breached in the insolvency manager, who had failed to inform of the criteria he was going to follow in the assessment of the insolvent company's proposal for an arrangement. There is "just cause" for removal in the issuing of a report with statements which, without sufficient basis, completely and absolutely demolish the insolvent company's proposal for an arrangement, without taking on board that the arrangement is the last resort to avoid liquidation. The court held that the insolvency manager had not acted in an appropriate and responsible manner.

DECISION dated March 16, 2012 rendered by Bilbao Court of First Instance No. 9

Transitional provision number one of the Insolvency Law. Formation of the assessment section. A breach of the arrangement with creditors approved before the entry into force of the Insolvency Law determines the opening of the liquidation phase. Art. 163.1.2º LC: the expression "solely for the purpose of implementing the liquidation phase" only precludes the possibility of opening the common and arrangement phases, but not the opening of the assessment section.

DECISION dated March 26, 2012 rendered by Madrid Commercial Court No. 6

Arts. 14 and 176 bis LC. Petition for an insolvency order. Insufficient assets to meet the post-insolvency order claims that would arise following the insolvency order, where there are no plans to bring clawback action, to challenge, or to seek third-party liability or assessment of the insolvency proceeding as fault-based. Existence of the scenario in art. 176 bis LC introduced by the insolvency reform in Law 38/2011. The court decided to conclude the insolvency proceeding in the same decision as the order because it could already be seen when it was rendered that there would be insufficient assets.

4. AWARDS

"The Legal 500" – First Tier Firm in Restructuring and Insolvency

The Legal 500 Series has been providing up-to-the-minute legal information on one hundred countries for over 20 years now and is a benchmark for the financial and legal markets. Garrigues is one of the four firms to be singled out as a first-tier firm in

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Restructuring and Insolvency. The Legal 500 praises Garrigues for its "knowledge and expertise, practical vision and proactive approach". The directory also stresses the full confidence the team inspires in its clients and the hard work performed by the Firm.

"IFLR 1000" – Tier One in Restructuring and Insolvency

The IFLR 1000 are based on the law firm recommendations of in-house counsel at the world's most prominent financial institutions, as well as the leading lawyers in each practice area. For the sixth year running, ever since the IFLR first dedicated a special section to the restructuring and insolvency area, the team has been named a Top Tier European Firm.

"Chambers Europe 2012" – Band 1 in Restructuring and Insolvency

Chambers & Partners is among the directories of choice for lawyers and law firms. Coming on top of the restructuring and insolvency practice area's recent inclusion as a Band 1 firm in the Chambers Global 2012 guide, the team made it two out of two by claiming the same top honors in Chambers Europe 2012, dedicated to the legal market in Continental Europe and the UK.

5. PUBLICATIONS

"**Spain: Key new legislation introduced by the Insolvency Reform Law**", [Fernández, A., Garcia-Alamán, B., Thery, A., Verdugo, J.], Global Restructuring Review 2012/2013.

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