3-2012
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1. CASE COMMENTARIES

JUDGMENT of the Barcelona Provincial Appellate Court dated April 23, 2012

Arts. 164, 165 and 172 (currently amended as art 172 *bis*) Insolvency Law ("LC").-- Directors contested penalty imposed by reason of their liability for insolvency after insolvency assessed as fault-based.-- Existence of irrebuttable presumption in art. 164.2.5 LC that there has been fraudulent outflow of assets or rights from debtor and determining assessment of insolvency as fault-based: it was not evidenced that related companies which received payment provided actual services to insolvent party. Invoices are not sufficient proof.-- Existence of rebuttable presumption in art. 165.1 LC that there has been willful misconduct or gross negligence in causing or aggravating insolvency due to breach of duty to petition for insolvency in due time.— Appellant objected to amount of penalty imposed on ground that it did not correspond to actual losses occasioned by his delay in petitioning for insolvency. Nature of directors' liability and of court order to make good asset shortfall in whole or in part: the fact that the penalty associated with such liability is not punitive in nature does not necessarily mean it is indemnificatory; function of indemnification, and requirement that liability be for damage and fault. Art 172 *bis* LC is a provision dealing with apportionment or attribution of risks.

Commentary:

The Barcelona Provincial Appellate Court had previously held that the penalty associated with the liability of the director of an insolvent company, as formerly provided for in art. 172.3 LC (now art. 172 *bis* LC) was indemnificatory or compensatory in nature, meaning that liability for damage or fault required evidence of causation between the conduct of the director and the detriment occasioned to the creditors. The Supreme Court seemed to have endorsed this view in its decisions of October 6 and November 17, 2011. However, in its judgment dated April 23, 2012, the Provincial Appellate Court reconsidered its stance in a landmark interpretation of the Supreme Court decisions referred to by introducing a number of important nuances into its view on the nature of directors' liability.

The Barcelona Provincial Appellate Court pointed out that the fact that the penalty associated with such liability was not punitive in nature (as confirmed by the First Chamber of the Supreme Court) did not mean that it was necessarily indemnificatory. The Court took the view that when the Supreme Court was referring to the function of indemnification, it was not referring to direct damage, but rather to the "*damage that was indirectly caused to the creditors*," meaning that there was no requirement that there be evidence, or even the existence, of a causal relationship between the amount of the penalty and the fact or event giving rise to the finding of a fault-based insolvency.

In the Court's opinion, art. 172 *bis* LC was a provision apportioning or attributing risks, which no longer weighed upon the creditors and were shifted to the company's director when he engaged in types of conduct that allowed the insolvency to be deemed to be fault-based. It was therefore not a question of evaluating to what extent the shortfall in assets was a direct consequence of the conduct that had led to the assessment of the insolvency as fault-based, but rather one of evaluating to what extent the shortfall was attributable to the directors, for which purpose all the facts with which the fault-based nature of the insolvency was associated must be taken into consideration, both as a whole and separately.

In view of all the above, the proven facts were not taken into consideration as facts giving rise to a specific type of damage (as would be the case if the evaluation were made from the standpoint of an action for damages), but rather as another parameter that enabled the attribution of the shortfall or deficit to the directors pursuant to their conduct to be correctly evaluated.

DECISION of Soria Court of First Instance and Examining Court no. 2 (Commercial Court) dated July 5, 2012.

Art. 113 LC.-- Refusal to admit for consideration proposed arrangement for third-party assumption of business and debt (*convenio de asunción*) submitted by creditor of insolvent party, due to formal defect: it was not submitted by creditors whose claims accounted for one fifth of total liabilities. Proposed arrangement also contained substantive defects: (i) 25-year rescheduling of debt proposed for subordinated creditors was disproportionate; (ii) payment of post-insolvency order claims was not determined; and (iii) no record of insolvent party's consent to transfer as required by this type of arrangement.

Commentary:

The proposal for the arrangement not admitted for consideration was submitted on June 20, 2012 by a creditor of the insolvent party, although it subsequently procured the adhesion of other creditors. Under the proposal, the insolvent party's production unit would be acquired by using the mechanism of an arrangement for third-party assumption of business and debt as regulated in art. 100.2 LC.

The LC allows creditors to submit proposals for arrangements, but imposes as an essential requirement (ex. art. 113.1 LC) the condition that their claims in the insolvency proceeding exceed, in percentage terms, one fifth of total liabilities. The LC does not distinguish between general and preferred creditors, or any other type of creditor. Instead, it expressly states that creditors, without specifying their class, may submit a proposal for an arrangement so long as their claims as whole, or individually, exceed one fifth of total liabilities. Accordingly, all pre-insolvency order claims, regardless of their classification, must be taken into account in calculating the one-fifth proportion.

Moreover, art. 99 LC requires that when the proposal is submitted it must be signed by all of the proposing creditors or by their respective representatives holding sufficient authority, and the signatures must be duly authenticated.

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However, in the case at hand, the proposal was submitted by a sole creditor as a proponent whose claim was not even close to reaching, in percentage terms, the one fifth of total liabilities required to be admitted for consideration. Indeed, such percentage was not reached either, even on the assumption that the subsequent adhesions by other creditors were valid.

For this reason, the proposed arrangement for third-party assumption of business and debt was not admitted for consideration.

The decision also highlighted (but did not go into an assessment of) other potential defects detected in the proposal submitted:

1. The proposal established a period of 25 years for rescheduling the payment of the subordinated claims. However, the proposal did not justify, nor did any reasons transpire from the viability plan for, a period longer than the 5-year period envisaged as the ordinary limit in art. 100.1 LC for the payment of the claims, despite the insolvent party having a special impact on the economy. The decision stated that merely citing a special impact could not justify setting such an excessively long and disproportionate rescheduling period for payment of the subordinated claims.

2. The proposal did not determine the payment of a material amount of the post-insolvency order claims, nor did it envisage their payment in the viability plan, something which could make it impossible to comply with the arrangement.

3. Even though it was an arrangement for third-party assumption of business and debt, there was no record of consent by the insolvent party to the disposal of the production unit. However, this circumstance in itself would not prevent the proposal from being admitted for consideration, although it could determine noncompliance with the arrangement.

2. HEADNOTES

Supreme Court

JUDGMENT dated April 16, 2012 rendered by Chamber I of the Supreme Court

Art. 128.1 LC.—Standing of the State Tax Agency to object to the approval of an arrangement with creditors. The State Tax Agency has the standing conferred by art. 128.1 since, despite also being a creditor in the case under consideration, it attended the creditors' meeting as an insolvency manager. Insolvency manager status meant that it was not necessary to be unlawfully deprived of the right to vote at, or not to attend, the meeting in order to be eligible to object to the approval of the arrangement.-- The 10-day period to object to the approval of the arrangement was a procedural time limit.

JUDGMENT dated April 26, 2012 rendered by Chamber I of the Supreme Court

Arts. 164, 165 and 172 LC.-- Assessment of insolvency as fault-based. Willful misconduct or gross negligence of a director in causing or aggravating the *de facto* insolvency of a company. Presumption of existence of willful misconduct or gross negligence due to the

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failure of the director to discharge his duty to cooperate with insolvency managers. The director was ordered to make good the shortfall in assets.-- The judge must assess the subjective and objective elements of the director's behavior in relation to the conduct that has affected the assessment of the insolvency as fault-based. An order against the directors of an insolvent company to pay its creditors all or part of the claims not received by them from the proceeds of the liquidation of the assets is not a necessary consequence of the assessment of the insolvency as fault-based, but requires an added justification as a result of such assessment.

JUDGMENT dated March 21, 2012 rendered by Chamber I of the Supreme Court

Arts. 164.2.1 and 172.3 (as worded before the reform by Law 38/2011, of October 10, 2011) LC.-- Order made in the assessment section of an insolvency proceeding against the company's director to make good the shortfall in assets due to material book-keeping irregularities. It was sufficient to engage in the negative conduct defined as a presumption in art. 164.2.1 LC for the insolvency to be assessed as fault-based, although he had not caused or aggravated the insolvent party's *de facto* insolvency.-- The former wording of art. 172.3 LC (now art. 172 *bis* LC) did not require aggravation of the state of *de facto* insolvency in order to penalize the directors, for which reason the order against the director to make good the shortfall in assets was justified.

JUDGMENT dated March 21, 2012 rendered by Chamber I of the Supreme Court

Art. 62.3 LC.—Maintenance, in the interests of the insolvency proceeding, of an electricity supply contract, the termination for breach of which had been sought. Conversion of the pre-insolvency order claims arising from the supply relationship into post-insolvency order claims as compensation for the supplier of the "expropriation" of its power to terminate the contract.

JUDGMENT dated March 26, 2012 rendered by Chamber I of the Supreme Court

Arts. 61.2 and 84.2.6 LC.-- Classification of claim arising from the payment of the secured obligation by the insolvent party's guarantor. The payment by the guarantor after the insolvency order had been made did not make the guarantor's claim by reason of such payment a post-insolvency order claim. Instead, the claim remained a pre-insolvency order claim, despite the fact that it was considered a new claim resulting from the filing of an action for reimbursement under art. 1838 Civil Code ("CC") rather than an action for subrogation under art. 1839 CC. In conformity with art. 84.2.6 LC, obligations to be performed by the insolvent party will only qualify as post-insolvency order claims if they arise from contracts containing outstanding reciprocal obligations, a quality which does not exist in a guarantee-type relationship, for which reason the claim arising from the execution of the guarantee ranks as a pre-insolvency order claim.

JUDGMENT dated March 27, 2012 rendered by Chamber I of the Supreme Court

Art. 55.1 LC (as worded before the reform by Law 38/2011, of October 10, 2011).-- Concurrent conduct of an administrative enforced collection proceeding and an insolvency proceeding. The administrative proceeding can continue if the decision to commence it was made before the insolvency order, but only in respect of the asset considered by the Provincial Appellate Court as not being necessary for the insolvent party's business.

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

Art. 128.1 LC.-- The standing of a creditor who is also an insolvency manager to contest the approved arrangement on the ground that it concealed the global liquidation of the insolvent party's assets. The holding of the dual status of insolvency manager (required as such to attend the creditors' meeting) and creditor (entitled not to so attend) allowed the creditor to attend the meeting solely in his capacity as an insolvency manager. Such insolvency manager status means that there need not be any unlawful deprivation of the right to vote, or non-attendance, at the creditors' meeting to be able to exercise the right to object to the approval of the arrangement.-- The 10-day period to object to the approval of the arrangement was a procedural time limit.

JUDGMENT dated April 17, 2012 rendered by Chamber I of the Supreme Court

Art. 87.7 LC.-- Partial payment of debts to a creditor before the insolvency proceeding by a third party without an interest, and with the debtor/insolvent party being unaware of such payment. The Court was asked to reduce the creditor's claim by the amounts paid by the third party.—Impossibility of applying by analogy arts. 87.7 LC and 160 LC, pursuant to which a principal creditor whose claim is partly satisfied by a third party (guarantor, surety, or a debtor jointly and severally liable with the insolvent party) is entitled to have the entirety of his claim (the portion paid plus the portion still owed) recognized in the insolvency proceeding and, therefore, to collect from the insolvent debtor the outstanding amount with preference over the third party who is subrogated to the creditor's partially satisfied rights.-- The partial payment by a third party without an interest in the obligation (because he is not a guarantor, surety, or a debtor jointly and severally liable with the insolvent party) does not result in subrogation, but rather the recognition of a new claim in his favor in the amount satisfied. As a result, the original creditor's claim must be reduced by the part of the claim which has been satisfied.

JUDGMENT dated April 26, 2012 rendered by Chamber I of the Supreme Court

Arts. 164, 165 and 172.3 (currently amended as art. 172 *bis*) LC.-- Insolvency assessed as fault-based by reason of the willful misconduct or gross negligence of the company's director in causing or aggravating the company's *de facto* insolvency. The presumption that there is willful misconduct or gross negligence on the part of the company's director arose because of the breach of the duty to cooperate with the insolvency managers. Liability of the director for the shortfall in assets and order against the director to make good such shortfall.-- It falls to the judge to assess, pursuant to legislative criteria, the various subjective and objective elements of the behavior of each of the directors in relation to the conduct that has affected the assessment of the insolvency as fault-based, with a view to identifying which directors are liable and the portion of the debt or shortfall that they must make good.-- In addition, the insolvent party does not have standing to appeal against the order made against its director in the assessment section of the insolvency proceeding.--

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

Arts. 100, 128 and 134 LC.-- Objection to arrangement with creditors.-- The Court held that it was not possible to object on the basis of the inappropriateness of the insolvency order, because it was not one of the grounds for objection provided for in art. 128 LC.-- The Court also held that an objection could not be made based on the lack of standing of

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the creditors who voted on the arrangement, because their presence on the list of creditors was not challenged in due time and form.-- Furthermore it was not possible to found an objection on the failure to specify in detail the terms of the arrangement as regards the payment of subordinated creditors. It was sufficient for the arrangement to establish the bases for being able to determine such payment, and it was also possible to do so by secondary application of the LC, paying the subordinated creditors pursuant to the terms established in art. 134 LC.

JUDGMENT dated May 14, 2012 rendered by Chamber I of the Supreme Court

Arts. 8 and 133.2 LC.-- The approval and entry into force of an arrangement render the insolvency order ineffective thereafter, including the sole and exclusive jurisdiction of the judge in the insolvency proceeding. The judge will therefore not be competent to hear a legal claim against the assets of the insolvent party after the approval of the arrangement with creditors.

JUDGMENT dated May 21, 2012 rendered by Chamber I of the Supreme Court

Arts. 164 and 172 LC.-- Insolvency assessed as fault-based at first instance and upheld as such on appeal. Appeals in cassation and against procedural infringements filed against the judgment of the Provincial Appellate Court.-- The Supreme Court held that the cassation appeal did not constitute a third instance that could review the assessment of the evidence made by the lower instance courts and dismissed the appeals on the ground that there was sufficient evidence of the commission of (i) a material irregularity in the accounting records affecting the understanding of the financial or asset position; and (ii) a serious inaccuracy in the documentation submitted with the insolvency petition, since the books of account recorded fictitious assets and receivables the amount of which was sufficient to render false any accounting analysis.—Merely engaging in the types of positive or negative conduct described in art. 164.2 LC was sufficient for an assessment of the insolvency as fault-based, even if those types of conduct had not had an impact on causing or aggravating the state of *de facto* insolvency. The Supreme Court upheld the decision ordering the asset shortfall to be made good on the ground that the indemnificatory function of the order provided for in art. 172.3 LC did not permit the connection with the grounds on which the insolvency was found to be fault-based to be avoided (art. 164.2 LC).-- Dissenting opinion on the interpretation of art. 172.3 LC as regards the criteria for attribution of liability. An express additional justification (causation) was necessary and this did not exist in the judgment appealed against. For the sake of greater legal certainty, the criterion to be considered in each case for directors' liability and its scope must be the impact that the conduct warranting the assessment of the insolvency as fault-based has had on causing or aggravating the state of *de facto* insolvency, since this allows the liability of the directors in each case to be gauged.

Provincial Appellate Courts

JUDGMENT dated February 9, 2012 rendered by Panel 15 of the Barcelona Provincial Appellate Court

Art.178.3 LC.-- Extinguishment of the legal personality of the insolvent party due to the end of the insolvency proceeding as a result of the absence of assets and the closure of the sheet on the register. A presumption that the company has ceased to exist must be deemed

to arise in favor of *bona fide* third parties, but does not operate in the case of subsisting creditors. Subsistence of the legal personality and procedural capacity of the insolvent party when the proceeding was commenced against its creditor.

JUDGMENT dated February 13, 2012 rendered by the Zaragoza Provincial Appellate Court

Art. 87.3 LC.-- Ancillary proceeding challenging the classification of pre-insolvency order claims. Conversion of the claim by the insolvent party's guarantor, recognized by the insolvency managers as a contingent claim, into a general claim, after the debt guaranteed to the third-party creditor was satisfied.-- The claim conversion request was not subject to the mandatory 10-day period indicated by art. 96 LC.-- Given the lack of evidence as to the specific amount of the claim paid to the third party, the Court upheld the conversion of the guarantor's contingent claim into a general claim, solely in respect of the amount that had been evidenced.

JUDGMENT dated March 5, 2012 rendered by Valladolid Provincial Appellate Court

Art. 61.2 LC.-- Termination, in the interests of the insolvency proceeding, of an agreement for the purchase of a property by the insolvent party. Neither the breach of contract by the insolvent party nor the consent of the party not in breach were decisive; instead, the interests of the insolvency proceeding were key. The interests of the insolvency proceeding were the preservation and maximization of the value of the insolvent party's assets in order to better meet or pay the claims of its creditors.-- Obligation of the party not in breach to restitute the price already paid by the insolvent party, albeit without interest, since contractual termination has *ex nunc* effects.-- Indemnification paid to the party not in breach due to the failure to deliver the balance of the price and the loss occasioned.

JUDGMENT dated March 15, 2012 rendered by the Asturias Provincial Appellate Court

Arts. 71, 72 and 73 LC.-- Clawback action brought against a joint and several suretyship arrangement created by the insolvent party in favor of a third party. The Court held that the joint and several suretyship arrangement created was ineffective and that the restitution of any consideration given was not appropriate. The creation of a joint and several suretyship by the insolvent party to secure another's debt at the same time as the arrangement of a mortgage loan guaranteed by it had to be deemed an act detrimental to the assets and rights available to the creditors. Relevance of the factual details, circumstances and characteristics of the transaction allowing it to be discerned whether or not the transaction was performed for consideration and, in particular, whether there was a genuine reciprocity of interests, which does not require equivalence of performances as consideration, or, conversely, solely a pure benefit for one party, without any consideration in return. The creation of a suretyship arrangement to secure another's obligation was a commitment for the insolvent party's own assets, from which, in principle, no consideration was derived in return, nor was any indirect benefit for the insolvent party discerned. This all entailed an "unjustified trade-off in assets" for the insolvent party and, accordingly, the Court rescinded the suretyship arrangement created.

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JUDGMENT dated April 20, 2012 rendered by Panel 28 of the Madrid Provincial Appellate Court

Art. 71.3.2 LC.-- Clawback action brought against the personal guarantee and mortgage granted by the insolvent party to a group company that had obtained separate loans which were used to discharge pre-existing obligations. The matured transactions canceled with the principal of the loans were, from a substantive and economic standpoint, literally "substituted" by the new debt resulting from the loans now secured by a charge.-- The borrower and mortgagor's membership of the same group was not relevant.-- By providing a guarantee and mortgage that were not granted when the original obligation (now substituted) was entered into, the position of certain creditors was being favored over that of others, and this could even circumvent the application of the *par condicio creditorum* principle.-- Application of art. 10 Mortgage Market Law, which requires the existence of fraud in the act or transaction to be rescinded in order for a clawback action to succeed. The *consilium fraudis* means acting in the knowledge that the mortgage granted will interfere with the efficacy of the payment of the amounts owed to other general creditors, since the third parties favored by the mortgage will rank higher in priority, as their general claims become preferred claims.

Commercial Courts

DECISION dated May 28, 2012 rendered by Palma de Mallorca Commercial Court no. 1

Art. 55 LC.—Lifting of administrative attachment contravenes the literal wording of art. 55.3 LC. The Court decided to lift the attachment on the following grounds: (i) the right of separate execution must be construed narrowly; (ii) all assets or rights may be declared necessary, including even those that must be used or disposed of; (iii) Parliament equates a stay of ordinary execution with a stay of administrative execution in relation to assets required for the continuity of the business. It is not appropriate to speak of a stay as a mere standstill, but rather as the inclusion of the attached assets among the assets available to the creditors in the insolvency, free from previous attachments; (iv) by stating that the administrative execution of assets necessary for the continuity of the business is "stayed", art. 55 LC is proclaiming the inclusion of the attached assets, free and clear from charges, within the insolvency proceeding; (v) art. 43 LC allows assets to be used even without the authorization of the court; (vi) assets attached in an administrative enforced collection proceeding are not excluded from the deductions to be made to pay post-insolvency order claims (art. 154 LC); and (vii) if the attachment were not cancelled, the asset or right could not form the subject matter of the enforced collection proceeding (which would not be able to continue) or of the insolvency proceeding (which would not be able to realize it).

Directorate-General of Registries and the Notarial Profession

DECISION dated April 18, 2012 by the Directorate-General of Registries and the Notarial Profession

Arts. 44, 132, 133, 137 and 155 LC.-- Appeal filed by a notary against the refusal of the property registrar to register a deed recording a giving in payment.-- The debate concerned whether or not, in a scenario where according to the registry a company which was the registered owner of certain properties, and the company absorbing it were both subject to

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insolvency proceedings, it was possible to register a deed in which the latter company gave the properties in payment of debts, with an attorney-in-fact appearing whose representative authority pre-dated the insolvency order, and in which the notary merely noted that the proposed arrangement had been approved.-- The instrument lodged contained a record of an official copy issued by the authorizing notary of a note signed by the court clerk of the relevant Commercial Court evidencing approval of the arrangement under a final court decision, as a result of which the insolvency managers stood down and the duties of the company's directors were restored on the dates indicated.—The registrar refused to register the deed (although he considered that the defect was curable) on the grounds that the participation of the insolvency managers, rather than the directors, in the business was necessary, since there was no record at the registry of the court decision nullifying their control over the insolvent party's powers, and that the arrangement had to be previously registered at the registry.-- The Directorate-General partially upheld the notary's appeal on the ground that the insolvency managers' powers to participate in the business had lapsed automatically with the approval of the arrangement and the powers of the company's directors had been restored, and that prior registration of the arrangement was not essential for the validity of the chain of title at the registry. Accordingly, the registration of the deed recording the giving in payment was valid.-- However, the Directorate-General confirmed the registrar's interpretation as regards the need to lodge the arrangement in order to assess whether it contained any limitations on or prohibitions against management or use, so as to record them in the relevant entry.

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