GARRIGUES

RESTRUCTURING AND INSOLVENCY

MAY 2016

CONTENTS

1941-2016 GARRIGUES

RESTRUCTURING AND INSOLVENCY

01 CONCLUSIONS OF THE CONFERENCE OF SENIOR COMMERCIAL JUDGES

Conclusions of the Conference of Senior Judges specializing in Commercial Matters held in Pamplona on November 4, 5 and 6, 2015 (in relation to insolvency matters)

Last November, Spain's most senior commercial judges discussed a range of current topics, in both the commercial and insolvency fields.

The discussions relating to insolvency issues centered on three main themes: the arrangement with creditors, the "second chance" mechanism, and practical problems encountered when transferring production units.

1.1. On the subject of arrangements, the main conclusions were as follows:

- Judges cannot, of their own motion, refuse to admit for consideration a proposal for an arrangement if they consider that it contains reductions that are too high, relying on the alleged existence of a disproportionate trade-off, because there is no legal basis for such a decision. Those matters must be assessed, where appropriate, by the creditors by casting their vote. Nor can they assess this matter, of their own motion, at the phase for court approval of the arrangement. Again, the issue would have to be raised by a creditor.
- If an arrangement includes the conversion of debt into equity, the instruments necessary for the conversion will be subject to the rules on majorities laid down in articles 198 and 201.1 of the Revised Corporate Enterprises Law.
- Dissenting creditors do not hold the right to object, under article 334 of the Corporate Enterprises Law, to a capital reduction transaction adopted during the insolvency proceeding. Any objections by these creditors would have to be submitted in the context of the approval of the arrangement.
- Lastly, for the approval of an arrangement affecting preferred creditors, a single voting session must be conducted. The majorities relating to each group of creditors must be calculated on the basis of the outcome of that session.

1.2. Concerning the second chance mechanism, the following conclusions were reached:

- Minor offenses must be regarded as falling within the meaning of "offense", as set out in article 178 bis.3.2 of the Spanish Insolvency Law (*Ley Concursal* or "LC").
- It is not possible for insolvency judges to grant debt relief where, even though none of the requirements in article 178 bis.3 LC are met, the debtor is found to be acting in good faith and it is considered that the missing requirement is not related to the act of causing or aggravating the situation of technical insolvency, or to the assumption of obligations, or to their non-performance.
- It is not possible for insolvency proceedings to be provisionally struck off, nor is it possible for them to be concluded before the final decision granting or refusing debt relief.
- Debt relief covers public law claims and domestic support claims for debtors not subject to a payment plan under article 178 bis.3.4 LC.
- The suspension of the accrual of interest on outstanding debts for a five-year period following the conclusion of the insolvency proceeding, under article 178 bis.6 LC, does not preclude the calculation of interest if debt relief is revoked.
- Holders of post-insolvency order claims have the authority to apply for the revocation of debt relief.

1.3. Lastly, on the practical problems encountered when transferring production units, the most important conclusions were as follows:

- The existence of jobs or human resources is not required in order to delineate the definition of production unit.
- It is possible for an arrangement to propose the disposal of every production unit.
- Approval by the shareholders' meeting is not a prerequisite for the disposal of an essential asset during insolvency proceedings.
- The undertaking by the acquirer to ensure the continuity of the business of a production unit must imply the obligation to pay statutory claims (of an employment and social security nature).
- The labor courts have jurisdiction to determine the limits on subrogation to social security contributions in respect of the employment contracts transferred.

02 CONSULTATION

Consultation of March 3 2016 issued by European Commission, on an effective insolvency framework within the EU
This consultation asks about the key insolvency barriers. It focuses in particular on gathering views on:

- the efficient organization of debt restructuring procedures;
- the rationale and the process for debt discharge for entrepreneurs (and its possible extension to consumers).

Beyond these two policy areas, the consultation also invites views on selected aspects of efficient and effective insolvency frameworks which may have particular importance for the Internal Market or the integration of capital markets. Such frameworks should help to maximise the value received by creditors, shareholders and other stakeholders.
The responses will be used to identify which aspects should form part of a legislative initiative and other possible complementary action in this field. The responses will be taken into account alongside the results of an external economic study carried out on behalf of the Commission as well as other evidence and analysis. The results of the consultation are without prejudice to any potential future Commission proposal.
This consultation is run via the 'EU-Survey' online tool, which makes it easier to collect answers from the widest possible range of respondents. In addition to choosing from the pre-defined answers, respondents are encouraged to explain their views or add additional information or explanations in the free text boxes provided. Respondents can add additional information at the end of the consultation and/or can do so by clicking on the 'other' options and the boxes that follow.

More information here: https://ec.europa.eu/eusurvey/runner/d7d623cb-371b-4ba4-8131-4a1ca5d07e8c?draftid=87639ea4a6b447b4890d73bede106630&surveylanguage=ES&serverEnv=&captchaBypass=false

03 SELECTED COURT CASES AND MAJOR SETTLEMENTS

3.1 *"Fiesta" case: Ruling of the Directorate-General for Taxes of December 16, 2015*

The liquidation plan for Fiesta, S.A. envisaged the separate transfers of two production units: (i) the candy production business unit; and (ii) the real estate business unit. As regards the first unit, a request was submitted concerning the contribution of parts of that unit to a newly created subsidiary ("Newco") with a view to, subsequently, transferring all of the shares in Newco to a third-party acquirer. Accordingly, as a result of contributing the business unit to Newco, the latter would be subrogated for use of the tax loss carryforwards of Fiesta S.A. generated by the line of business thus transferred, which Newco could offset against future income.

In this context, the Directorate-General of Taxes ("DGT") issued a ruling on the following issues: (i) whether the described transaction could be carried out under the special tax regime of the Corporate Income Tax Law (Ley del Impuesto sobre Sociedades or "LIS"); (ii) if so, whether Newco could be subrogated for use of the tax loss carryforwards generated by the line of business transferred by Fiesta S.A.; and (iii) whether the restrictions on tax loss carryforwards laid down in article 26.4 LIS would apply.

With respect to the first issue, the DGT found that, since the transaction qualifies as a non-monetary contribution of a line of business and is based on an orderly liquidation, ensuring the continuity of the business and safeguarding jobs, it could be carried out under the special tax regime in the LIS. Concerning the second issue, the DGT stated that Newco could indeed be subrogated for use of the tax loss carryforwards in accordance with article 84.2 LIS. Lastly, on the third issue, the DGT ruled that Newco could offset tax losses against the income for subsequent tax years, since the restrictions on carryforwards laid down in article 26.4 LIS do not apply.

3.2 *"Someva" case: Decision dated February 8, 2016 rendered by Valencia Commercial Court No 2*

In the context of the validation of a refinancing agreement, an application was made for clarification of a number of factual errors in the validation decision as well as for admission of the supplementary petition requesting for it to come into effect from the date of the refinancing agreement rather than the date of the validation order. The court found that the court decision validating the refinance agreement was not declaratory but rather had operative effect, for its terms to become binding on creditors. Therefore, binding terms take effect not as a result of the refinancing agreement, but as a result of the court decision validating the refinancing agreement. In the light of the foregoing, the court dismissed the supplementary petition.

3.3 *"Intersa" case: Judgment dated February 18, 2016 rendered by Murcia Provincial Appellate Court*

The provincial appellate court upheld the judgment of the lower court and dismissed the application for a finding of invalidity in relation to guarantees provided in 2009 which were subsequently ratified in 2011 alongside the provision of new guarantees. In relation to the 2009 guarantees, the provincial appellate court considered that the requirements allowing them to be clawed back had not been met: there was no detriment to creditors, as the decisions had not undermined the capacity of the insolvent party to repay their claims, nor was there any fraudulent conduct. With respect to the 2011 transactions, these could not be subject to clawback in the insolvency proceeding, because: (i) some acts entail the ratification of earlier guarantees, not the provision of new ones; (ii) the new guarantees were provided as consideration for an extension of the grace period for the financial debt, giving liquidity to the insolvent party; (iii) the insolvency manager did not prove the significance for and economic impact on the insolvent party of the provision of the disputed guarantees; and (iv) the provision of the new guarantees did not amount to an unjustified asset trade-off.

3.4 *"Atalayas" case: Decision dated March 15, 2016 rendered by Alicante Commercial Court No 2*

Garrigues advised Atalayas Building Properties 2015, S.L. ("ABP"), a company belonging to the Jofel group, on the implementation of a refinancing agreement and its subsequent court validation. Together with the provisions usually found in transactions of this kind (deferrals, reductions, new interest rates and new repayment schedules), the validated agreement also contained a provision requiring the only dissenting creditor to accept – by making its terms binding on that creditor on validation– a reduction to its collateral package and the provision of funding to ABP to enable it to comply with the viability plan.

The specific terms that became binding on the dissenting creditor included: (i) the remission (reduction) of interest, paid or unpaid, accrued during a period prior to the formalization of the refinancing agreement; (ii) the obligation to repay to the insolvent party certain income received as a result of a pledge of rights in its favor; and (iii) the obligation to release income pledged in its favor.

3.5 *"Delforca" case: Decision dated April 19, 2016 rendered by Barcelona Provincial Appellate Court*

The insolvency court ordered the stay of an arbitration proceeding, arguing, in essence, that the proceeding was at a pre-arbitration stage and not "in progress" when the insolvency order was handed down, because the request for arbitration had not yet been filed, even though the application to submit the matter to arbitration had already been made. At the same time, the court ordered a stay of the effects of the arbitration agreement due to it being detrimental to the conduct of the insolvency proceeding, having regard to the cost of the arbitration, its financial significance and its decisive impact on the insolvency proceeding, given that the insolvency order on the ground of imminent technical insolvency was based on a possible finding of liability in this case.

On appeal, the provincial appellate court held that the arbitration proceeding had commenced with the request for arbitration to the arbitral tribunal, pursuant to article 27 of the Arbitration Law and the Rules of the tribunal itself. This means that the arbitration cannot not be divided into a pre-arbitration phase, falling outside the arbitration proceeding, and an actual jurisdictional phase. Therefore, in accordance with article 52.2 LC, the arbitration had to continue until the award became final, since it was already "in progress" when the insolvency order was made. Furthermore, since the stay of the effects of the arbitration agreement could not, under any circumstances, affect the ongoing arbitration, which must continue until completion,

the provincial appellate court rejected the arguments alleging that it was detrimental, which were centered on the advisability of the dispute being settled within the context of the insolvency proceeding. For that reason, the provincial appellate court also revoked the stay of the arbitration agreement.

04 GROUPS OF CASES: LIQUIDATION TRANSACTIONS

4.1. *4.1. Judgment dated February 11, 2015 rendered by Barcelona Provincial Appellate Court*

The lower court approved the liquidation plan proposed by the insolvency manager and ordered that the expenses and taxes associated with the transfer had to be borne by the purchaser, in view of the insolvent party's inactivity and its limited cash flow. The provincial appellate court set aside the judgment of the lower court because the taxpayer, for the purpose of the tax on increase in urban land value, which applies on transfer, is the party which transfers the land on account of being the direct beneficiary of the gain. Charging that tax to the awardee, which was the credit institution holding the mortgage being realized, would mean imposing a tax on it for which it is not legally liable, with the consequent reduction to its collateral. To conclude, neither the lack of cash flow nor the need to ensure that post-insolvency order claims are paid in the order laid down by law justify the imposition of taxes on the mortgagee for which it is not legally liable.

4.2. *Decision dated June 24, 2015 rendered by Valencia Provincial Appellate Cour*

The provincial appellate court upheld the appeal filed by the creditor financial institution in relation to the following points: (i) the insolvency judge cannot, of their own motion, make amendments to the liquidation plan which depart from the amendments to which the insolvency management and the creditors have consented; (ii) nor can the insolvency judge impose repossession on the financial institution creditor as they have no basis in law to do so; and (iii) it is not possible to impose expenses and taxes on purchasers contrary to mandatory tax provisions.

4.3. *Judgment dated March 16, 2016 rendered by A Coruña Commercial Court No 1*

The judgment upheld the appeal for reconsideration lodged by the insolvency manager against the decision refusing removal of the charges created in favor of certain creditors before the disposal of registered properties subject to a condition subsequent. The court, in line with the arguments put forward by the insolvency management, held that article 149.5 LC must be interpreted in a way that is consistent with the other provisions of the Insolvency Law. Accordingly, if the disposal is performed by the insolvency manager in accordance with the liquidation plan, and if court authorization is not required because the disposal does not involve assets or rights allocated to the payment of specially preferred claims, the disposal may be preceded, at the request of the insolvency manager, by the lifting of such charges, so that the assets may be transferred free and clear of charges and encumbrances.

4.4. *Decision of the Directorate-General of Registers and the Notarial Profession dated March 16, 2016*

The Directorate-General of Registers and the Notarial Profession was called upon to decide whether, when a mortgage is removed, the mortgagee's consent is necessary, or whether, by contrast, the court decision expressly ordering that removal is sufficient. The liquidation plan may choose the appropriate asset realization method. It is necessary in all cases to take into account the rights of mortgagees, whose appearance in the process as parties means that they may be aware of the plan. Thus, the order directing the removal of the security interest must contain a record of the fact that the mortgagees were aware of the liquidation plan and the measures taken to pay their specially preferred claims. It will therefore be necessary to hear or notify that class of creditor in order to satisfy the above requirement.

05 INSOLVENCY ROUND-UP

5.1. *Simultaneous insolvency order and conclusion of insolvency proceeding: Decision dated November 12, 2015 rendered by Madrid Provincial Appellate Court*

The provincial appellate court confirmed the simultaneous insolvency order and conclusion of the insolvency proceeding against an individual due to there being insufficient assets available to creditors. The debtor had appealed against the order handed down by the lower court, arguing that the insolvency proceeding was not one involving an absolute lack of assets because foreclosure was taking place against a property, which might have been enough to pay their debts. The provincial appellate court held that the insufficiency of assets had to be assessed from the standpoint of efficiency – any insignificance or irrelevance as regards the assets must be equivalent to insufficiency. Since there was no clear expectation that there would be surplus proceeds from the foreclosure of this sole asset, the court found that it would be ineffectual to appoint an insolvency manager and increase the post-insolvency order claims.

5.2. *Application of a national rule to determine the liability of directors: Judgment of the Court of Justice of the European Union of December 10, 2015*

The case involved an insolvency proceeding opened in Germany against a company incorporated in the United Kingdom with an establishment and its center of main interests in Germany. An action was raised against the director of the company under a provision of German law which did not form part of German insolvency legislation. The action sought a declaration of liability for payments made by the company to third parties before the opening of the insolvency proceeding but whilst the company was in a situation of insolvency. The following questions were referred for a preliminary ruling: (i) does the provision of German law apply to the directors of the foreign company?; and (ii) is the action compatible with the freedom of establishment within the EU?
The court held that article 4 of the Regulation, which provides that the lex fori concursus determines the "conditions for the opening" of insolvency proceedings, must be interpreted as meaning that the preconditions for the opening of insolvency proceedings, the rules which designate the persons who are obliged to request the opening of those proceedings, and the consequences of an infringement of that obligation fall within the scope of the lex fori concursus. Consequently, it upheld that the provision of German law applies to the defendant, since its effect is to penalize a failure to fulfill the obligation to apply for the opening of an insolvency proceeding. The court also held that the purpose of the provision of German law is to prevent any reduction of the assets available to creditors before the insolvency proceedings are opened so that the claims of all the company's creditors may be satisfied on equal terms. Accordingly, it is similar to the rules laying down the "unenforceability of legal acts detrimental to all the creditors" which, under article 4 of the Regulation, also fall within the lex fori concursus. The liability of directors governed in the provision of German law (liability for having made payment at a time when the directors were under an obligation to apply for the opening of insolvency proceedings) concerns neither the incorporation of a company in a Member State, nor its subsequent establishment in another Member State, nor the personal liability of directors where the capital of that company has not reached the minimum amount laid down by the national legislation, with the result that the action is not incompatible with the freedom of establishment enshrined in articles 49 and 54 TFEU.

5.3. *Debt relief: Decision dated January 25, 2016 rendered by Pontevedra Provincial Appellate Court*

The lower court refused to admit for consideration an application for debt relief filed by the insolvent individual as he had not demonstrated that they had first tried to reach an out-of-court payment agreement (acuerdo extrajudicial de pagos or "AEP") with their creditors. The provincial appellate court dismissed the appeal lodged by the debtor on the following grounds: (i) a prior attempt to reach an AEP is a necessary prerequisite for eligibility for debt relief, even where such an agreement is unlikely; (ii) sending creditors an offer for debt payment and debt remission is not an alternative to satisfaction of the abovementioned requirement; (iii) the fact that the AEP application form had not yet been approved when debt relief was applied

for did not prevent the debtor from applying for the AEP directly; and (iv) there was no denial of due process rights as claimed by the appellant because they could have evidenced the alleged refusal by the notary to open the AEP procedure but failed to do so.

5.4. *Assessment of the insolvency as fault-based: Judgment dated January 27, 2016 rendered by Chamber One of the Supreme Court*

The court conducted a detailed examination of the meaning of "accomplice" for insolvency law purposes and of the requirements to be accused of complicity. It held that two requirements must be met in order for complicity to be observed: (i) material assistance in the performance of the acts forming the basis of a fault-based assessment for the insolvency; and (ii) willful misconduct or gross negligence in the provision of such assistance, together with the insolvent party and its directors or liquidators. The court established the following guidelines as regards the requirements for complicity: (i) there must be sufficient evidence and it is necessary to demonstrate a clear causal link between the acts accused and proven in respect of the party held to be an accomplice and the specific acts of causing or aggravating the technical insolvency which served as the basis for the assessment that the insolvency was fault-based; (ii) the assistance provided by the accomplice need not pre-date the insolvency order, since the Insolvency Law does not lay down any time limit whatsoever in that respect; (iii) there must be a finding of consilium fraudis (fraudulent intention) or, at the very least, conscius fraudis (collusion with the insolvent party in the conduct classified as fault-based); it is not necessary to produce any other evidence of this subjective element or of an express intention to cause harm to the creditors, it being sufficient for there to be scientia fraudis (awareness of detriment to the creditors).

5.5. *Concept of "group of companies" for insolvency purposes: Judgment dated March 4, 2016 rendered by Chamber One of the Supreme Court*

The court held that, to support the subordinated nature of a claim on account of the holder being a "person specially related to the debtor", the point in time to be taken into consideration in order to determine the company's status as being in the same group under article 93.2.3 LC is the date on which the claim arose, not the date of the insolvency order. In this case, the appellant held 65% of the capital stock of the insolvent party when the claim arose. The court thus confirmed the existence of a group of companies, and therefore, the subordinated nature of the appellant's claim. In its reasoning, the court extended the meaning of group to take in all direct or indirect control that a company exerts over another, beyond mere control in terms of shareholding or control of the managing body (under article 42.1 of the Commercial Code).

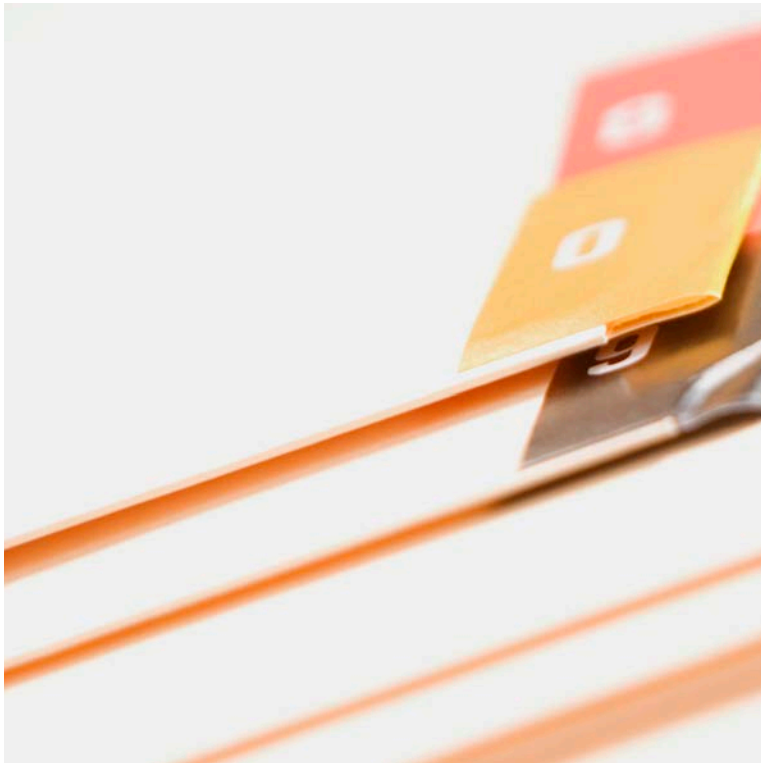
5.6. *Pledge of future claims: Judgment of March 18, 2016 rendered by the Supreme Court*

The Supreme Court set aside the judgments of the lower court which classified a claim secured by a pledge of future claims as an unsecured claim. The Supreme Court held that the acceptance of the transfer of future claims entails the acceptance of pledges of future claims. Accordingly, specially preferred status under article 90.1.6 LC has to be acknowledged, whenever, at the time the insolvency order is handed down, the contract has already been entered into or the legal relationship giving rise to the pledged future claims has already been established. The court also held that this case-law approach is reflected in Law 40/2015, of October 1, 2015, which expressly provides for the pledge of future claims in article 90.1.6 LC.

5.7. *Non-performance of the arrangement: Judgment dated April 8, 2016 rendered by Chamber One of the Supreme Court*

A number of creditors applied for a declaration of non-performance of the arrangement due to the non-payment of their claims. In this instance, the arrangement contained a clause requiring the creditors to notify to the debtor – within three months following the date on which the judgment approving the arrangement became final – the checking account into which their respective claims were to be paid. If no such notification was sent within that time limit, the creditor was automatically deemed to have waived its entitlement to receive the first payment under the arrangement. The Supreme Court held that there was nothing to prevent the parties

reaching agreement on those terms. Accordingly, the clause in question was valid and the creditors who had not notified their bank account on time were deemed to have waived the first payment under the arrangement.



06 NEWSFLASH

6.1. *Drop in the number of insolvency proceedings*

According to figures published by the Register of Experts in Forensic Economics of the Spanish General Council of Economists, refinancing agreements and insolvency mediations gained ground over insolvency proceedings in 2015, a trend which is expected to continue in 2016. The General Council of Economists estimates that, in 2016, the number of insolvency proceedings will fall by 20%, resulting in a year-end figure of 4,000 proceedings of this kind.
Statistics from the Spanish National Statistics Institute show that the number of insolvency proceedings fell in the first quarter of 2016 by 27.6% compared to the same period in 2015.

6.2. *Increase in refinancing agreements*

According to the Register of Experts in Forensic Economics, a specialist body of the General Council of Economists, the first quarter of 2016 saw a 30% increase in the number of validated refinancing agreements, reaching the figure of 33 validations (there were 25 validations in the same period in 2015 and only 2 in 2014). Nonetheless, it must be noted that the number of refinancing agreements reached is higher, since not all agreements were ultimately validated.
The same study shows that 80% of all refinancing agreements entered into since the Insolvency Law came into force (196) arose in the past two years.

07 GARRIGUES ARCHIVES

7.1. Publications

- **¿El reconvenio como alternativa a la liquidación? Estudio de la posibilidad de modificación del convenio a la luz de la Ley 9/2015, de 25 de mayo, de medidas urgentes en materia concursal** ("Are re-arrangements an alternative to liquidation? Review of the possibilities for amending arrangements in the light of Law 9/2015, of May 25, 2015, on urgent insolvency law measures") [González Pérez], La Ley, April 2016.
- **A propósito del concurso necesario de un hotel** ("Case study: the mandatory insolvency of a hotel") [Lorente Lara], CEHAT, May 2016.
- **Crossroads in EU harmonization on restructuring and insolvency: Towards a market-based model or one where "the senior takes it all"?** [Thery Martí], Revue Trimestrelle de Droit Financier, March 2016.

7.2. Awards

- **Legal 500** (Garrigues: Band 1 in Restructuring and Insolvency):

"Prominent firm with an expansive restructuring and insolvency team, traditionally active in advising debtor

companies, though increasingly also acts for financial institutions on insolvency proceedings. Active in the real estate and infrastructure sectors, clients benefit from its extensive network of offices."

Singled out as work highlights were the advisory services provided to BBVA as agent bank and to the syndicate of banks in connection with the refinancing of the Gallardo Group.
The lawyers from our Department who were classed as notable practitioners were Antonio Fernández, Borja García-Alamán, Adrián Thery and Juan Verdugo.

• Chambers Europe 2015
(Garrigues: Band 1 in Insolvency and Band 2 in Restructuring):
"Prominent firm with an expansive restructuring and insolvency team, traditionally active in advising debtor companies, though increasingly also acts for financial institutions on insolvency proceedings. Active in the real estate and infrastructure sectors, clients benefit from its extensive network of offices."

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• Chambers Europe Awards for Excellence 2016
Garrigues took the Client Service Award at the Chambers Europe Awards for Excellence 2016, in recognition of its ability to innovate and continuously improve the solutions it offers when handling the most complex legal issues arising in global business law.

• European Law Firm of the Year 2016
Garrigues was honored with the award 'Law Firm of the Year: Iberia', conferred by the UK publication *The Lawyer* at the annual European Awards ceremony. Garrigues was also one of the finalists (the only Spanish law firm) nominated in the category 'European Law Firm of the Year'..

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