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### SALES OF BUSINESSES IN INTERNATIONAL CASES: CLEAR OR NOT-SO-CLEAR TITLE?

#### *The Sale of Assets in Insolvency Procedures The Spanish Perspective*

*By*

*Agustin Bou Maqueda*

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# **The sale of assets in insolvency procedures. The Spanish perspective.**

**Agustín Bou<sup>1</sup>**

## **1.- Introduction.**

We must briefly describe, by means of an introduction, and before proceeding to analyze the topic hereby exposed, the structure of the Spanish insolvency procedure, as it may be difficult to understand, without said grounding, when and how assets can be transferred.

Only one insolvency procedure exists in Spain, the “Concurso de Acreedores”, which is governed by the Insolvency Act (Ley Concursal hereinafter, the LC) regardless of whether the company has anticipated its restructuring or its liquidation. This procedure begins with a common phase (in “Fase Común”) during which assets and liabilities are defined and the possible future viability of the company is analyzed. Once said phase has been completed, if the company can continue, the “phase to reach an agreement with creditors begins (“Fase de Convenio”) with the purpose of reaching an agreement with the creditors. On the contrary, if the company cannot continue, the Liquidation begins (“Fase de Liquidación”) in order to proceed with the disposal of assets and, within the company's limits, with the creditor payments.

The transfer of assets can take place during any of the procedure's phases, and it may comprise the sale of all activity, of some productive units, or of some assets. Requirements and formalities vary depending on when it is carried out.

## **2.- The transfer of assets during the Joint Stage.**

The core principle of the Common Phase is the prohibition to dispose of any properties in the body of assets (Article 43.1), as it is considered that said actions are to be carried out during the Liquidation, or shall eventually be determined within a hypothetical agreement with creditors.

However, LC also foresees the transfer of assets on an exceptional basis, *when said transfer is necessary for the continuation of the company's activity*, with the compulsory Court authorization. Therefore, assets may be disposed of during this stage, when extraordinary circumstances that justify the urgency of said transfer concur. In practice, these situations usually correspond with the deterioration of assets because of the lapse of time, or their high maintenance costs.

Article 43 does not establish any specific formal requirements for these transfers other than the compulsory Court authorization. Therefore, said transfers must be carried out in accordance with the rules on publicity and rights of attendance set forth within the general rules on transfers in bankruptcy procedures, in order to guarantee the transparency thereof, and the Court Judge is entitled to establish the procedure that shall be followed. In practice, restricted procedures are usual, as they are quicker and more dynamic than tendering procedures.

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<sup>1</sup> Agustín Bou is a partner at the firm JAUSAS, where he leads the Restructuring & Insolvency Department.

The recent crisis has proved that, in many occasions, the delay in making sales decisions eventually inflicted great damages upon creditors, given that the lapse of time implies a rapid deterioration of assets. Thus, although the nature of this measure is exceptional and restrictive, it has been widely applied in practice, to the point where the March 2009 amendment of the LC established the possibility to present an “advanced liquidation proposal” during the Common Phase to be carried out earlier during the procedure, in order to make the transfers more quickly. We will analyze this procedure when we explain the Liquidation Stage.

### **3.- The transfer of the company as a part of the Settlement Agreement with the creditors.**

Article 100.2 of LC allows the proposed agreement to include the transfer “*of the whole of the debtor's assets and rights involved with the corporate or professional activity, or of specific productive units in favor of a natural person or a legal person*”.

Therefore, LC allows the transfer of the company or of a productive unit thereof to be comprised within a proposed agreement, provided that three requirements are met: (i) the transfer must be in favour of a specific person; (ii) the buyer must undertake continuity of the corporate or professional activity inherent to the transferred productive units and (iii) the buyer must undertake the payment of credits to the creditors under the stipulated conditions in the proposed agreement.

Regarding the first requirement, the fact that the identification of the buyer in the proposed agreement is mandatory forces the debtor to act sufficiently in advance, given that, according to LC Article 114.2, once the agreement has been presented, it cannot be modified.

The second requirement, concerning the buyer's commitment to the continuity of the company's activity, should be interpreted in its broad sense. Therefore, the buyer is entitled to make the adjustments it deems necessary within the company's employment structure, provided that the activity is maintained and not denaturalized and the procedure by which said adjustments are made is clearly established within the proposed agreement and the relevant agreement with the employee's representatives has been reached, as we will discuss later.

The third requirement, regarding the undertaking of the creditors' credits as specified in the proposed agreement, is slightly confusing, as LC does not set forth any prorata or proportion rules, and therefore, the scope of said duty must be clearly specified within the proposed agreement. In this sense, if only one productive unit is acquired, but not the whole of the business, the proposed agreement must specify the obligations that are undertaken with regard to the insolvency procedure creditors very clearly.

On the other hand, if we find ourselves before the acquisition of the business as a whole, it is obvious that the amount of the offer, along with any present or future resources which may be in the debtor's power, must be sufficient in order to satisfy the obligations undertaken by means of the agreement.

The aspects related to the company succession as a result of such acquisition are also relevant in this case, and must be clearly specified in the proposed agreement. Such aspects will be analyzed in full detail in the last paragraph of this article.

The effective transmission of the business or the productive unit will take place when the agreement with the creditors has been duly approved by the Judge, unless it is opposed, in which case the corporate transfer will take place once the challenge has been solved. However, LC Article 129 empowers the Judge to adopt as many cautionary measures as necessary in order to guarantee the enforcement of the proposed agreement, including the sale of the business or the productive unit, even when the approval of the agreement has been challenged, in which case, the buyer must cautiously evaluate the consequences of a hypothetical adverse decision on appeal.

#### **4.- The transfer of the company during the Liquidation Phase.**

##### **4.1. Advanced liquidation.**

The Royal Law Decree 3/2009 of March 27 (The Decree), introduces a new Article in the LC, 142 *bis*, which governs the advanced liquidation, entitling the debtor to present an advanced liquidation proposal for the realization of assets prior to the closure of the Common Phase, in order to avoid the deterioration that may take place as a result of delays in its transfer. In fact, said proposal may even be presented along with the bankruptcy filings.

Once the Judge approves an advanced liquidation proposal, the liquidation phase begins with the same formalities that are required in an ordinary liquidation, with the only differences detailed as follows: (i) the advanced liquidation proposal is presented during the Common Phase within the procedure, and (ii) advanced liquidation may only be applied for by the debtor.

##### **4.2 Parties and proceedings in the Liquidation.**

The initiation of the Liquidation suspends the debtor's powers of administration, as these are attributed to the Bankruptcy Administrators, which will have to present a liquidation plan for the realization of assets and rights before the Bankruptcy Procedure's Judge. This plan, *“as long as it is feasible, must foresee the unitary disposal of the whole of the establishments, exploitations and whichever other productive units of goods and services belong to the debtor or one of the debtors.”* (LC Article 148).

In light of the above, and from an economic and social point of view, LC goes on the assumption that the joint disposal of all of the debtor's assets and rights is preferred over the individual and isolated realization of different elements in the company, and is therefore treated with priority.

The whole liquidation procedure is carried out under the Bankruptcy procedure Judge's control and in accordance with the rules of publicity and transparency. To this effect, the Judge will serve notice of the Liquidation plan to the parties in the procedure, who will be able to raise observations and proposals and, in view of said observations, may amend the Plan or reject it, in which case the liquidation will be carried out in

accordance with the additional rules set forth in LC, which will be analyzed later in detail.

#### 4.3 Disposal procedure of the body of assets.

LC foresees several sale mechanisms regarding the disposal methods of the properties in the body of assets: (i) direct sale; (ii) a realization agreement through a specialized entity and (iii) a tendering procedure. The Liquidation Plan may include combined proposals.

In practice, direct awarding procedures are habitually employed, provided that the compulsory pertinent publicity is facilitated to the possible interested buyers, by the means of circularizations sent to the competitors or other corporations operating in the same field, as well as, eventually, through advertising in specialized media, or any other method which may be determined by the Judge and, in the case of a plurality of interested parties, a restricted tendering procedure may be held before the Judge.

In the case that proposals regarding the liquidation procedure have not been made by the Bankruptcy Administrators in the liquidation plan, or by the debtor in the advanced liquidation proposal, said procedure will be carried out in accordance with the additional regulations in LC Article 149. Once again, said rules reinforce the prevalence of the sale of the business as a whole and, in the case of real estate property, its sale by the means of a public tendering.

#### **5.- Company succession in insolvency proceedings.**

As a general rule in the Spanish legal system, liabilities of tax, employment, and social security nature is also transferred when a business is acquired under continuity, due to which the buyer will automatically undertake all pending obligations of this nature at the time of the transfer. Said responsibility could comprise creditor debt, but this will only occur in a situation of fraud with the creditors declared as such by a Judge.

Within the scope of insolvency procedures, this rule is treated differently and produces different effects depending on whether the liabilities are of a tax, employment, or social security nature, with the purpose of stimulating the unitary sale of the business and the continuity of the company's activity, due to the beneficial effects that this may imply for the economy and employment.

If we find ourselves before tax liabilities, the criteria is clear: All debt of a tax nature related to the prior society are kept within the liabilities of the insolvency procedure, without actually affecting the new buyer.

On the other hand, the general rule concerning employment debt is that the rights (seniority, category, etc.) of all affected employees, including wage liabilities, are transferred, but the Judge may waive the buyer from the obligation to subrogate itself with regard to wages and severance pays pending payment prior to the transfer. The Judge may also authorize the amendment of the subrogated employees' working conditions provided that an agreement between the buyer and the employees' representatives is reached.

Social Security liabilities are the most controversial, as this body tends to consider that its liabilities are of a labour nature due to the fact that they are linked to wages, and has, in numerous cases, claimed the corporate succession. In our (widely accepted) opinion, such claim is clearly contrary to LC, given that it specifically foresees how said liabilities must be classified when it regulates each specific type of debt (LC Articles 90, 91 and 92), partially as secured, partially as unsecured, and partially as privileged.

Fortunately, the jurisprudential line from the Commercial Courts and Courts of Appeals to date has consistently rejected the Social Security's intentions. See, for example, Court Resolution of November 29, 2007, of the Article 15 of the Barcelona Court of Appeals.

Finally, it is important to keep in mind the obligations linked to environmental issues within the scope of company succession, given that these regulations affect land regardless of its ownership, and in the eventual case of a purchase of a productive unit with environmental issues, the new buyer will be obliged to comply and abide by said rules. This, however, does not apply to possible penalties arising from the failure to comply with environment-related regulations prior to the insolvency, which will not be transferred with the disposal, but will rather continue to be a part of the body of liabilities in the procedure, as would any other sanction of any given nature.

## **6.- Conclusions.**

LC revolves around the core principle of the unitary sale of the company (or of its autonomous productive units) over the individual disposal of each one of its elements.

Said unitary sale may occur by means of an agreement approved by the majority of creditors. When an agreement cannot be reached, or in the situations mentioned above in paragraph 3.1, liquidation of the bankrupt company will take place. Likewise, LC shall stimulate the global sale of the business.

LC comprises several rules that soften the generic corporate succession regime, with the purpose of promoting the unitary disposal of the company and the maintenance of employment.

Notwithstanding the foregoing, it is advisable to act in advance and as expeditiously as possible by the means of an advance liquidation proposal in those cases in which the unitary sale of a bankrupt company is feasible, as, in practice, the mere declaration of bankruptcy gravely weakens the company and only a swift and effective performance shall facilitate the successful conclusion of the corporate sale that is profitable for the creditors.