The consent of a secured creditor in the sale of productive units

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Is the consent of privileged creditors to the sale of productive units that include, inside its perimeter, one or more assets charged with a privileged credit, always required by the Spanish Insolvency Act or are there certain circumstances that may exclude this consent?

The problem that we are approaching in this article has been discussed recently by a few recent resolutions dictated by the Spanish Commercial Courts and the Provincial Courts, with a unanimous opinion by all parties involved still pending.

Article 149 of the Spanish Insolvency Act (IA), 'Liquidation Rules', states that, in the case where a Liquidation Plan has not been approved or in regard to every matter that may affect the liquidation that has not been set in the approved liquidation plan, certain subsidiary rules will apply. This article discusses Article 155.4 of the IA, which will apply to sale assets that are affected to privileged credits. If these assets are included inside the perimeter of any productive unit and this productive unit is sold including the asset, the following rules will apply:

1. **Sale with subsistence of the charge:** in this case, the consent of the privileged creditor will not be necessary if the purchaser is subrogated in the position of the debtor, having the court examine the solvency of the purchaser.
2. **Sale without subsistence of the charge:** privileged creditors will have the right to the proportional part of the purchase price, according to the valuation of the collateral in relation with the valuation of the productive unit. If the price to be received is not enough to cover the value of the collateral, calculated accordingly to IA Article 94.2, consent by privileged creditors with the right to a separate enforcement of the collateral will be requested.

   If there are various privileged creditors affected, at least 75 per cent of the privileged credits affected by the sale must consent to the sale, according to Article 94.2 of the IA.

   In this case, the part of the privileged credit that is not covered by the selling of the collateral will be classified by the Insolvency Administrator according to its nature.

   If the price to be received by the seller was equal or superior to the value of the guarantee, consent by the affected privileged creditors will not be requested.

   By exception, subrogation by the purchaser, even when the collateral subsists, will not be completed when the credits are classified as public credits, credits held by the tax administration and the social security administration.

The criteria to favouring the selling of productive units rather than individual assets is supported by the fact that it benefits the price obtained by the seller, as opposed to various individual assets being sold, and it helps the maintenance of employment. These principles cannot be forgotten when applying the IA. As a matter of fact, Spanish legislature insists in being flexible when applying the IA as too formalistic an approach can produce contrary effects to the ones desired.

Regarding all of the productive unit sale possibilities explained above, the one that creates most legal doubts is the sale of an asset included in a productive unit and charged with a privileged credit, without the subsistence of this charge, when the price obtained is insufficient to cover the valuation of the collateral, as per IA Article 94.5.

If a literal approach is taken to IA Article 149.2 and we exclude the interpretation of the referred article to Articles 56 and 57 of the IA, the thesis that supports that the consent of the privileged creditors to the sale of the productive unit is requested when the price obtained is below the value of the guarantee, may seem correct.[1]

This thesis constitutes a complement to the rules to the sale of individual collaterals established in IA, Article 155.4, which has not been modified and introduces a speciality regarding the sale of productive units. This rule establishes that, in the case where one privileged creditor is affected by the sale of its collateral and the price obtained by the sale is not enough to cover the valuation of the collateral, the privileged creditor must consent to the sale.

The singularity of IA Article 149.2 consists in that when the sale of a productive unit affects various privileged creditors with the right to enforce, in a separate proceeding to the insolvency proceeding, its collateral, the essential requirement of consent by the privileged creditors is fulfilled when 75 per cent of the privileged credits affected by the sale consent to the sale. The remaining privileged creditors who did not consent will be bound to the agreement. The legislator, when putting into balance the interests of all parties, decided to be more flexible with the unanimous consent request of the privileged creditors affected.

This singularity must also apply when considering the sale of one asset inside the perimeter of a productive unit that affects one privileged creditor.

The Spanish Supreme Court follows the general consent rule by privileged creditors with the right of a separate enforcement of the collateral, separating this rule from those rules established under IA Articles 56 and 57. This is because Article 57.3 cannot be considered as a sanction to creditors who have not enforced its right against a collateral before the start of the insolvency proceeding. In the end, this means that creditors who have enforced their rights before the initiation of the insolvency proceeding are in a better position, and the legislature does not want this.

In the author's opinion, that thesis does not comply with the consideration of privileged creditors in the Insolvency Act.

The recognition of a credit as privileged in an insolvency proceeding is based on a guarantee granted by the debtor and the faculty of the creditor to enforce this collateral to repay its credit. However, the recognition of a credit as privileged does not imply the recognition of a right to enforce separately the collateral. Separately means, in this case, outside the insolvency proceeding. If there is no insolvency proceeding because there is no insolvent debtor, the creditor can enforce the guarantee in one of the different enforcement proceedings existing in Spain's jurisdiction but will not have a right to enforce separately the guarantee, as there is no insolvency proceeding to enforce its right separately from. This means that the right to enforce on a separate proceeding its collateral by the privileged creditor is a right that only exists under an insolvency proceeding. If this insolvency proceeding does not exist, the right to enforce in a separate proceeding the collateral by the privileged creditor does not exist.

Having said this, the regulation of the right to enforce separately the collateral appears in IA Articles 56 and 57. It is also necessary to take into account that Article 147 says that during the liquidation phase the rules contained in Title III of the IA will continue to be of application, unless other rules contradict them specifically. That right is granted to privileged creditors who have enforced their rights against the collateral before the initiation of the insolvency proceeding, to those who initiate the enforcement right against the collateral after one year since the insolvency proceeding has been declared, unless the liquidation phase has started and to those who enforce the right against a collateral, which is not necessary for the continuation of the productive activity of the debtor. This separation right is lost if, before the opening of the liquidation phase, it has not been enforced.

As explained up to now, others cannot align with the Supreme Court's thesis, which does not take into account the regulation of the right to enforce separately a collateral when applying IA Article 149. If the right is considered as a right that also exists outside the insolvency proceeding, it is suggested that it is a right that only exists if an insolvency proceeding is in place. If it is considered that the loss of the right when the liquidation phase is opened is some kind of sanction or discrimination to those who had not started the enforcement prior to the declaration of the insolvency proceeding, it is not in accordance to the insolvency principles, which establish the general liquidation of all assets inside the proceeding. The right to enforce separately the collateral by a privileged creditor is a faculty that assists those who have complied with the temporary requirements of the IA.

Conclusion

Given all of the above, in the case of sale of productive units that include, inside its perimeter, one or more assets charged with a privileged credit, considering the preference in selling these assets or assets along the productive unit over a singular enforcement of the assets by the privileged creditor, the following situations must be taken into account:

1. *Sale with subsistence of the charge*: in this case the consent of the privileged creditor will not be necessary if the purchaser is subrogated in the position of the debtor, having the court to examine the solvency of the purchaser.
2. *Sale without the subsistence of the charge*:
    - (i) If the price to be received by the seller was equal or superior to the value of the guarantee, consent by the affected privileged creditors will not be requested.
    - (ii) If the price to be received was inferior to the value of the guarantee, we have to differentiate:

- If the privileged creditor maintains, according to Articles 56 and 57 of the Spanish Insolvency Act, the right of a separate enforcement of the guarantee, this creditor must consent to the sale. If there are various privileged creditors affected, at least 75 per cent of the privileged credits affected by the sale must consent to the sale, according to article 94.2 of the Spanish Insolvency Act.
- If the privileged creditor has lost its right to enforce separately its guarantee as per Article 57.3 of the Spanish Insolvency Act, its consent will not be necessary.

Note

1 625/2017, 21 November 2017, Spanish Supreme Court.

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The principle of 'no creditor worse off' under Portuguese law

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Directive 2014/59/EU of the European Parliament and of the Council dated 15 May 2014 established a framework for the recovery and resolution of credit institutions and investment firms (the 'Bank Recovery and Resolution Directive' or BRRD),[1] and is of major interest. The underlying principle is that a bank resolution occurs when national authorities determine that a failing bank cannot go through normal insolvency proceedings without harming public interest and causing financial instability. This article deals with the Portuguese implementation of the 'no creditor worse off' approach.

According to Article 34 of the BRRD, the shareholders of the institution under resolution are the first to bear losses (eg, national authorities may decide to transfer the shares or all or part of the assets of the bank to a private purchaser without the consent of shareholders). Creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings (eg, national authorities may decide that only some liabilities are transferred out of the failing institution to a new institution). However, there are two important exceptions. First, deposits that are covered by a guarantee scheme are fully protected. Second, no creditor shall incur greater losses than would have been incurred if the bank had been wound up under normal insolvency proceedings instead of resolution measures. This is known as the 'no creditor worse off' principle (the 'NCWO principle'). The principle goes back to the Roman rule of equal treatment of creditors, the famous Magna Carta of every insolvency legislation.

Article 74 of the BRRD obliges the Member States to ensure that a valuation is carried out by an independent person as soon as possible after the resolution action or actions have been effected. The aim of such valuation is to determine whether the treatment of the creditors that will result from the resolution measures will put the creditors in a position at least equal to that they would have received in normal insolvency proceedings. Moreover, Member States must ensure that, if the valuation shows that a creditor will incur greater losses than that the creditor would incur in a winding up under normal insolvency proceedings, that creditor is entitled to the payment of the difference from the resolution financing arrangements.

Portugal implemented the NCWO principle into its existing Act on Financial Institutions (*Regime Geral das Instituições de Crédito e Sociedades Financeiras* or RGICSF). Pursuant to the original wording of Article 145.º-B, 145.º-F and 145.º-H of the RGICSF, which became effective in August 2014,[2] creditors whose claims had not been transferred to another financial institution were entitled to claim the difference from the state fund if, upon termination of the winding-up of the bank, it appeared that they would have received a more