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Briefing note

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Case law of interest in terms of project financing

In this briefing we will be summarising the most relevant points of law on which judgment number 38/2014 handed down on 12 February 2014 by Commercial Court no. 1 in Alicante was based, in the context of the insolvency of Ciralsa Sociedad Anónima Concesionaria del Estado ("**CIRALSA**"), in relation to the financing of the project for the construction, operation and maintenance of the Alicante toll ring-road and other obligations derived from the administrative concession awarded by RD 282/2004 of 13 February

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Brief background to the case

On 4 August 2005, CIRALSA entered into a senior facility agreement with several financial institutions in order to finance the costs and expenses derived from the construction, operation and maintenance of the Alicante toll ring-road and other obligations derived from the administrative concession awarded by RD 282/2004 of 13 February. Under said financing, a guarantee agreement was granted in order to secure fulfilment of the obligations under the facility agreement, and CIRALSA assigned as security for the financial institutions the credit rights derived or that may derive in the future, vis-à-vis the respective agreement counterparties, from the Project Accounts, the Project Agreements (including, among others, the concession contract) and from the Interest Rate Hedging Agreements, referred to in the senior facility agreement of 4 August 2005, and established an *in rem* right of pledge in favour of the financial institutions over said credit rights.

The following is also relevant for the purposes of this briefing:

- Bankia owns 100% of Corporación Financiera Caja Madrid, S.A.
- Corporación Financiera Caja Madrid, S.A. owns 99.98% of Sociedad de Promoción y Participación Empresarial Caja Madrid, S.A.
- At the date the facility agreements were signed Sociedad de Promoción y Participación Empresarial Caja Madrid, S.A. owned 25% of CIRALSA

What type of credit right is RPA?

Government asset liability (*Responsabilidad Patrimonial de la Administración* or RPA), must be understood as *ex lege* liability of contractual origin, deriving as it does from the termination of an administrative concession agreement, the maximum amount of the same being determined by the agreement itself and the calculation method, meaning that it can be ascertained without the need for a new agreement between the parties.

Therefore, according to the judgment, it can be concluded that the RPA is a future credit right, because even though its existence is envisaged in the agreement itself, as of formalisation, such right arises or is activated when the agreement is terminated – acting as a kind of condition precedent.

Scope of the special privilege in the pledge of future credits over the RPA

On the basis of the fact that a debtor can pledge future credits that have not materialised at the time the guarantee is established, the judgment confirms that there is no doubt that the pledge covers all credits materialising until the declaration of insolvency. Nevertheless, it adds that the answer is not unanimous in relation to credits that materialise after the declaration of insolvency, because the question is whether they materialise in the head of the debtor-insolvent party, as an asset that is freely included in the insolvency assets without privileged status for the creditor, or whether, on the other hand, they are attached to the pledge and, as a result, the secured creditor is the recipient of said assets.

Article 90.1.6 of the current wording of the Insolvency Act does not offer any solution regarding the scope of the privilege, and therefore the examining magistrate, as in the earlier judgment of 20 July 2012, analyses the different theories maintained by doctrine (absolute immunity, the intermediate theory, the strict theory and the theory of analogy) before focusing on the recent judgment of the Supreme Court dated 6 November 2013. In light of this judgment, the magistrate states, we have confirmation of the doctrine according to which the assignment of future credits as a guarantee is resistant to the subsequent insolvency process of the assignor, if, at the time it was agreed, the defining characteristics of the credit being assigned were already appropriately determined, meaning that "*it materialises immediately in the head of the assignee, based on the expectation of acquisition already having been transmitted while the assignor still had the freedom to dispose of its assets*". Although aware that there are some differences between an assignment of credits and a pledge of credits, the judge considers that in view of the connection between the two concepts, there is nothing to prevent this doctrine being applied to a pledge of credits.

In short, given that the RPA refers to a future credit right under a concession agreement whose defining characteristics were already appropriately determined at the time it was agreed (prior to the insolvency) – the judgment establishes that the amount was envisaged and was determinable *ab* *initio*-, the outcome is that the pledge established over the credit is enforceable even if the RPA materialises after insolvency, in which case the pledge will already exist over the same.

The judgment puts an end to the discussions on this point by highlighting the change in criteria with respect to its prior judgments on the same matter. As regards case law, there is the added factor that there are clear differences of a factual nature between both cases being examined which justify the strict theory having been opted for in the past (including, among others, the fact that the pledge was implemented barely seven months before the insolvency and over a considerable part of the debtor's assets, leading to a high level of the payment expectations of ordinary creditors in general and of the credits derived from maintaining the business activities not being met), whereas in the case at hand it is deemed more appropriate to opt for the intermediate theory.

Scope of the special privilege in the pledge of the project accounts

Article 15 of Royal Decree 5/2005 cannot be analysed without bearing in mind that, given its scope, what is in fact pledged in the case at hand is almost all the ordinary and extraordinary income which the insolvent party obtains from its business activities. In this context, the judgment establishes that the terms of the immunity from the insolvency process mentioned in such Article must be defined.

The judgment goes on to state that the terms of this Article do not mean that practically all income derived from the insolvent party's activities, which should serve to increase the pledged accounts, is granted a pledge from the outset, as this would render the principle with respect to maintaining corporate activities under Article 44 of the Insolvency Act misleading, given that the said pledge would be enforceable without any restrictions whatsoever.

The granting of the pledge under Royal Decree 5/2005 does not release the pledgee from verifying the prerequisites which the pledged right must meet, and in particular its definition (Article 1.273 of the Spanish Civil Code), whereby the only credits that may be granted a pledge from the outset are those arising after the pledgor's insolvency and which are fully determined or which may be determined by virtue of criteria which do not fall to the sole discretion of the pledgee or, according to the Supreme Court "*that the defining characteristics of the credit in question are appropriately determined, at the latest when such credit materialises, without any need for the parties to enter into a new agreement …*".

The subordination of insolvency credits held by the shareholders with an indirect stake in the insolvent party

Reference to the legal system

The Insolvency Act establishes in Articles 92.5 and 93.2.1, as currently worded, that the insolvency credits of those shareholders which, when the credit right materialises, are owners of, at least, 5% of the share capital (if the company declared insolvent should have securities listed on an official secondary market), or 10% (if it does not) will be deemed subordinated credits. The foregoing does not however apply to those credits which are not loans or acts with analogous purposes held by the shareholders who meet the above requirements to hold a stake in the share capital.

The original version of the Insolvency Act enacted in 2003 did not refer to the timeframe for verifying stakes held in the insolvent party's share capital, to ascertain whether or not the credit should be considered subordinated. When the Act was amended in 2009, the legislator confirmed that such verification should only be carried out at the time the credit right materialises, and not afterwards.

Having dealt with this first issue, the legislator still needed to determine to what extent holding a stake in the insolvent party's share capital should be deemed exclusively a direct stake or, on the contrary, if the classification of subordinated credit could extend to those creditors with an indirect stake in the insolvent party.

Prevailing jurisprudence: literal interpretation of the legal system and extension of the status of shareholders to indirect stakes

In light of the absence of legislation on this matter, several Provincial Courts have issued rulings on this matter (Judgment 107/2008 handed down by the Toledo Provincial Court (Section 1) on 14 March, Judgment 53/2012 handed down by the Castellón Provincial Court (Section 3) on 1 February, or Judgment 66/2012 handed down by the Castellón Provincial Court (Section 3) on 9 February), concluding that for verification purposes not only direct shareholders but also those holding an indirect stake in the insolvent party should be deemed shareholders. Of particular relevance is Judgment 107/2008 handed down by the Toledo Provincial Court (Section 1) on 14 March, which emphasised the need to apply a literal interpretation of Article 93.2.1 of the Insolvency Act, without analysing other considerations like attempted fraud or falsification, bad faith or the intention to cause damages to other creditors. The Judgment also stated that evidence to the contrary is not permitted when assessing whether persons should be considered specially related to the insolvent party, unlike the situation covered by Article 93.3 of the Insolvency Act.

New interpretation: subjective analysis associated to the specific facts of the case

The judgment analysed in this briefing was handed down precisely in the context of the voluntary insolvency of a company (CIRALSA) in which the financial institution (Bankia) owned an indirect stake in the insolvent party (through the stake which Bankia held in Corporación Financiera Caja Madrid, S.A. and in Sociedad de Promoción y Participación Empresarial Caja Madrid, S.A.), as indicated in the background section above. Furthermore verification of the stake held, as established in Article 93.2.1 of the Insolvency Act, was carried out at the time the credit materialised.

In the judgment, the judge confirms that the shareholder with a direct stake in the insolvent party is a specially related person, although when analysing whether this circumstance must be projected on to the financial institution (with an indirect stake in the insolvent party), the following considerations are made:

- from a literal point of view, the shareholder must be deemed the owner of the shares or participations of the insolvent party, without being able to assert the status of indirect shareholder; in the judge's opinion, it is not possible to extensively interpret a sanctioning and exceptional regulation such as the credit subordination rule;
- from a systematic point of view, the situation of the creditor's indirect stake is already covered in paragraph 3 of Article 93.2 of the Insolvency Act, in which it must be assessed whether it is admissible to assert the special relationship due to the existence or non-existence of a corporate group, this being the special rule that replaces paragraph 1 of the same Article; and
- remedying fraud of law.

These arguments are put forth in order to avoid taking part in the conclusions reached by the Provincial Courts mentioned above. The judge highlights that even while conscious of the existence of these judgments and the decisions they contain, he confirms that he does not agree with their conclusions for the reasons mentioned.

In view of evasive manoeuvres meant to render Article 93.2.1 of the Insolvency Act inapplicable (for example, by means of creating dummy corporations or pathological group scenarios), the judge understands that the obstacle to these must be Article 6.4 of the Spanish Civil Code, which prevents fraud of law, rather than an extensive or similar application of Article 93.2.1 of the Insolvency Act. Therefore, ultimately this would entail lifting the corporate veil of the intermediary company and attributing the status of true shareholder to the creditor.

In light of the foregoing the judgment concludes as follows:

- no fraud whatsoever is detected in the case at hand, which cannot be presumed merely due to the existence of numerous company stakes, as the concept of corporate group is a reality admitted by the legislator; and
- in any case, it is not clear what advantage the financial institution could obtain, or the potential risk for other creditors, by entering into the credit arrangement, on account of an affiliate company holding 25% of the share capital of the financed company, bearing in mind the circumstances arising in the arrangement of the credit, which derives from a syndicated banking operation, subject to the control and supervision inherent to such operations.

Although it should be borne in mind that this judgment does not constitute case law, we are of the understanding that it should be taken into consideration due to the fact that the arguments contained therein are well prepared and founded, and it is likely that its theories will be referred to in the future by other courts dealing with similar matters.

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