

## The long-lasting effects of financial assistance, M&A and insolvency

Madrid, December 2021

The Spanish Supreme Court (SC) has recently issued a ruling<sup>1</sup> confirming that unlawful financial assistance provided by a company many years before being declared insolvent can still determine the classification of the insolvency as fraudulent (*concurso culpable*).

Even though the circumstances of the case are not clearly explained, the judgment is a timely reminder of the important implications that unlawful financial assistance may have, particularly now, given that, after a period of great activity in the M&A markets (until 2009 or so) followed by some years of relative quietness, the current excess of liquidity has resulted in record volumes of deals. At the same time, the effects of the crisis deriving from the Covid-19 and other macroeconomic circumstances will probably increase the number of corporate financial crisis. For these two reasons it is likely that the legal implications of financial assistance return to the fore soon.

Pursuant to article 150 of the Spanish Companies Act a company cannot advance funds, grant loans or guarantees or provide any kind of financial assistance to a third party for the acquisition of its own shares or the shares of its parent company<sup>2</sup>.

The consequences of this sort of financial assistance may be a pecuniary sanction, the nullity or the rescission of the financial assistance itself and possibly of the acts inseparably linked to it, the liability of the directors of the company having granted the financial assistance, the classification of the insolvency as fraudulent (which in turn may imply the liability of the company's directors), etc. These consequences have different limitation periods that broadly speaking go from two years for the rescission or four years for the nullity to an indefinite period for directors' insolvency liability as in the case at hand.

In this judgment, the SC has found that the financial assistance granted by an Opco to its Holdco fourteen years ago may still have consequences despite the fact that most of the above time limits may have already elapsed.

The main facts are as follows:

- In 2001 a SPV (Holdco) was set up to acquire 88% of the shares of an operating company (Opco). Holdco financed part of the purchase price with bank loans.
- The service of the acquisition debt was initially paid with Opco's own funds and from 2009 through a syndicated bank loan, seemingly granted to Opco.

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<sup>1</sup> Judgment of the Spanish Supreme Court 726/2021 dated 26 October 2021.

<sup>2</sup> See our note *Financial assistance provided by a company for the acquisition of its own shares*, March 2019.

- Opco was declared insolvent in 2015.

Both the commercial court and the León Court of Appeal found that the push of Holdco's debt *down* to Opco amounted to illegal "indirect" financial assistance and declared that the insolvency was fraudulent pursuant to article 164.1 of the former Insolvency Act<sup>3</sup>. These courts considered that the financial assistance, although provided many years before the insolvency, had worsened Opco's situation and entailed a grossly negligent behaviour on the part of its director.

For this reason both Opco's director and Holdco were directed to pay the insolvency's debts up to the amount of the outstanding amount of the financial assistance (the former as the "person affected" by the classification of the insolvency and the latter as his "accomplice")<sup>4</sup>.

Both Holdco and Opco's director appealed the decision before the SC alleging, *inter alia*, that when assessing the cause or the worsening of the insolvency the court may not review an "infinite past", as both courts had done by founding their decision in a financial assistance granted fourteen years ago.

The SC partially dismissed the appeal and confirmed that any acts by the debtor, however old, may be examined when classifying the insolvency (even if they have become time-barred in other respects such as nullity or rescission).

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<sup>3</sup> Currently, article 442 of the Consolidated Text of the Insolvency Act.

<sup>4</sup> When an insolvency is declared fraudulent the judge must determine the individuals affected by such declaration and their accomplices, if applicable. Amongst other measures the judge may order to (i) return any assets of the debtor unlawfully obtained (ii) lose any claims towards the debtor, and (iii) compensate damages. Additionally, individuals affected by the classification of the insolvency may be held liable for debts of the insolvent company insofar as their behavior has generated or worsened the insolvency.