

Refinancing, damages, *anticipatory non-performance* and cross default

Madrid, July 2022

In January 2013 Thisa and other companies of its group entered into a refinancing framework agreement (RFA) with their financial creditors, including Banco Santander. Thisa and Santander also concluded two contracts in accordance with the RFA, namely an invoice discounting agreement and a €1.4 million loan.

In July 2014 a Madrid commercial court declared Thisa's insolvency and Santander stopped fulfilling the invoice discounting agreement on the grounds that Thisa's commercial claims were allegedly non-performing.

Thisa then filed a claim for damages against Santander before the insolvency court. Thisa argued that Santander's breach of contract reduced its cash flow and hence its ability to buy stock, make sales and generate revenues. It submitted an expert report claiming that the drop in Thisa's *stock to sales ratio* after the declaration of insolvency (4.7 per cent) was exclusively due to Santander's breach of contract.

Santander counterargued that it had been released from its obligations under the invoice discounting agreement when Thisa was declared insolvent, as it then became clear that Thisa would not repay the €1.4 million loan (*anticipatory non-performance*). Santander contended that both contracts were interconnected as they arose from the RFA, which provided for common rules on the termination of all contracts deriving from it (including those between Thisa and Santander) and, in particular, on their early termination should any borrower company of the Thisa group fail to pay any amount to any lender under any contract. Santander further asserted that the unavailability of funding had not caused any damage to Thisa.

The court resolved that Santander had breached the invoice discounting agreement and was therefore liable for the damages caused to Thisa. It found, however, that the drop in the *stock to sales ratio* (4.7 per cent) was only partly due to Santander's breach of contract (2.7 per cent) and calculated the damages accordingly.

The Madrid Court of Appeal (MCA)¹ confirmed the first instance ruling (except as regards the amount of damages²) as it found that:

- (i) No *anticipatory non-performance* by Thisa had occurred.

Pursuant to case-law³, a party may early terminate a contract where it is objectively certain that there will be a fundamental non-performance by the other party.

¹ Judgment 76/2022 dated 9 February 2022.

² The MCA readjusted certain bases for calculating the damages caused by Santander.

³ Judgments of the Supreme Court 69/2013 and 511/2013 respectively dated 26 February and 18 July 2013.

The assessment of whether a breach of contract by Thisa was certain when it was declared insolvent and Santander stopped performing the invoice discounting agreement must be made on the basis of the information then available, without any hindsight bias.

At that time, it was far from certain that Thisa would not repay the loan at maturity, *i.e.* ten months later. On the contrary, Thisa had acted diligently trying to remedy its insolvency. It held negotiations with its creditors and hired a specialised firm for the purpose of restructuring its debt and then submitted an early composition proposal when it filed for insolvency.

Creditors holding more than 50 per cent of the insolvency claims adhered to the composition proposal, which however was not approved only because the legally required majority was raised by the 2014 reform of the Spanish Insolvency Act.

Furthermore, another financial creditor which, like Santander, had granted a loan to Thisa continued to fulfil its invoice discounting agreement despite the declaration of insolvency.

(ii) Obligations under both contracts were not interdependent.

Even if it were certain that Thisa was not going to repay the loan at maturity, Santander would not have been entitled to stop fulfilling its obligations under the invoice discounting agreement because they were not conditional on those of Thisa under the loan agreement.

The court concluded that no cross default had been clearly agreed despite the RFA's provisions mentioned by Santander. The invoice discounting and the loan agreements between Thisa and Santander did not expressly state that they were reciprocally conditioned, nor could this be deduced from their respective purposes. These contracts were autonomous, as evidenced by the fact that each of them had specific provisions on performance and non-performance.

In addition, Santander never said, before being sued, that it was not honouring the invoice discounting agreement because Thisa would not repay the loan or that the obligations under both contracts were interdependent.

Finally, the MCA found that the invoice discounting was essential to Thisa, especially since the beginning of the insolvency proceedings, when it became its only source of funding. Thus, stop discounting Thisa's invoices at that moment was undoubtedly harmful to the company.

This judgment not only explains the conditions under which an agreement can be terminated for *anticipatory non-performance*, but also shows the importance of clear cross default provisions, in particular in complex refinancing transactions.