Refinancing agreements and insolvency

Madrid, December 2018

A commercial court of Madrid has issued an interesting judgment[1] which annuls the syndicated refinancing provided to several companies belonging to the same group that were later declared insolvent, restores the lenders' claims against the insolvent companies to their former position and orders the lenders to return certain amounts of money to the insolvency estate.

Through the refinancing agreement, the parent company of the group was granted a facility divided into two tranches:

(i) Tranche A, of up to some €39.5 million, which was fully drawn down in order to cancel the pre-existing debts of the insolvent companies *vis-à-vis* the same lenders, some of them already due and payable (almost €12.5 million) and others still performing (some €32 million). As a condition for the refinancing, the remaining amount of pre-existing debts (above €5 million) was paid by the companies with their own funds.

(ii) Tranche B, of up to about €12.5 million, exclusively available for the discount of certain accounts receivable, subject to the lenders' prior approval. The lenders only authorised the borrower to draw down less than €1 million.

Both the parent company and its subsidiaries guaranteed repayment of the refinancing facility by means of several securities (pledges and mortgages) and personal guarantees, even though the pre-existing debts had not been secured at all. The lenders eventually collected around €4 million by enforcing a pledge over bank account balances.

The insolvency administration requested the court to rescind the refinancing pursuant to article 71 of the Spanish Insolvency Act (IA), which provides for the rescission of any act carried out by the debtor within two years prior to the declaration of insolvency (as was the case of the refinancing agreement) that is detrimental to the insolvency estate.

The court started by reminding that, according to the Supreme Court case-law, (a) not only the acts that result in a decrease of the debtor's assets but also those that alter the creditors' parity of treatment (*par condition creditorum*) must be rescinded pursuant to article 71 IA if carried out within two years prior to the declaration of insolvency, and (b) parties' awareness of the detriment caused is not a requirement for the act to be rescinded (objective detriment itself is enough).

The court noted that, where securities are granted as collateral of pre-existing debts or debts that replace the pre-existing ones, there is a presumption of detriment that may only be rebutted if the company that eventually went insolvent obtained a

[1] Judgment of the Madrid Commercial Court nº 6, dated 28 June 2018.

significant benefit as a result of the refinancing, whether in the form of "fresh money" or of an extension of the repayment term, to such an extent that the company could have become economically sustainable.

On this basis, the court highlighted that (i) tranche A (almost €39.5 million) was entirely meant to cancel pre-existing debts for the same amount, (ii) the insolvent companies were obliged to pay the remaining pre-existing debts (more than €5 million) with their own funds, (iii) around 75% of the pre-existing debts (above €32 million) were not due and payable yet and (iv) the lenders only authorised the borrower to draw down less than €1 million of tranche B.

In light of the above, the refinancing not only did not improve but deteriorated the liquidity of the insolvent companies, which barely received €1 million of "fresh money" and paid more than €5 million to the lenders with their own funds. The securities granted under the refinancing agreement, which were valued in excess of €44 million, were therefore not proportionate to the liquidity obtained.

Furthermore, the court underlined that the payment of more than €5 million and the securities granted to the lenders were detrimental to the rest of creditors of the insolvent companies, and thus altered the *par conditio creditorum*.

The two-year repayment term provided by the refinancing agreement was not considered sufficient to justify the grating of the collateral, not least because most of the pre-existing debts (almost €32 million) were still not due and payable.

Accordingly, the court decided to rescind the refinancing agreement and reinstate the lenders' original claims. As a result, the court ordered the lenders to return to the insolvency estate: (i) severally (*mancomunadamente*), some €5 million received from the borrower as a condition for the refinancing; (ii) jointly and severally (*solidariamente*), around €4 million obtained from enforcement of the pledge over bank account balances; and (iii) jointly and severally (*solidariamente*), about €3 million paid by the insolvent companies for taxes, fees and expenses related to the refinancing agreement.

This judgment is a reminder of the radical consequences that may result from refinancing agreements by which the lenders are granted new securities by a debtor that is declared insolvent within the next two years, unless the agreement improves the liquidity of the debtor or extends the repayment term to an extent sufficient to reasonably justify the granting of those securities.

It is noteworthy that, despite the refinancing had been granted severally by the lenders, the court ordered them to pay the money collected from enforcement of the pledge jointly and severally because of the lack of evidence on the allocation of that money among the lenders.