

Sale of business units within insolvency proceedings, secured creditors and good faith

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The Spanish Supreme Court (SC) has recently issued a very interesting judgment¹ regarding the sale of a business unit (BU) within insolvency proceedings in which collateral was cancelled without the express consent of the secured creditor.

A bank (BMN) granted an engineering company (Servicios) a loan which was secured by a pledge of the latter's rights resulting from certain contracts it had entered into with another company (Airbus).

Servicios was later declared insolvent and BMN requested that its claim was ranked as *pecially privileged* (i.e. secured) in the insolvency proceedings because of the pledge. However, the insolvency administrator classified BMN's claim as *ordinary* and the insolvency court confirmed that; thus, BMN filed an appeal before the Barcelona Court of Appeals (BCA).

Before the BCA ruled on the appeal, another engineering company (CITD) submitted a bid for the acquisition of two Servicios' BUs for a price of €500 each; one BU included the engineering contracts with Airbus and the other consisted of several assets.

The insolvency court approved the transaction and noted that the assets were to be transferred to CITD "free of liens and encumbrances". Nevertheless, it pointed out that there was a pending appeal regarding BMN's pledge of rights and the classification of its claim.

CITD then informed Airbus that, as a result of the acquisition of the BU including the engineering contracts, it had subrogated to Servicios' position in them. Therefore, Airbus began making the contractual monthly payments to CITD.

In the meantime, the BCA reversed the insolvency court's decision about the ranking of BMN's claim and declared that it was *pecially privileged* (i.e. secured). BMN then notified Airbus that CITD's rights deriving from the engineering contracts were pledged in favour of BMN and that, therefore, Airbus had to pay BMN instead of CITD.

In view of that, CITD requested the insolvency court to prohibit BMN from making further demands for payment to Airbus, on the grounds that the BU had been transferred free of charges and BMN had neither objected to the sale nor appealed the court's order that approved it. The insolvency court upheld CITD's claim and its judgement was confirmed by the BCA.

BMN then appealed the BCA's decision before the SC because of an alleged infringement of article 149.2 of the former Spanish Insolvency Act (IA)², pursuant to

¹ SC judgment nº 694/2020, dated 29 December 2020.

² Article 214.1 of the consolidated text of the IA that entered in force on 1 September 2020.

which, in a sale of a BU including rights or assets that secure insolvency claims, the consent of at least 75 per cent of the affected secured creditors is necessary if their collateral is to be cancelled and the sale price is lower than the collateral value. BMN noted that the price paid by CITD for the BU (€500) was derisory and far below the value of the rights under the Airbus contracts.

The SC upheld BMN's appeal for these reasons:

- (i) The price offered by CITD for the BU consisting of the Airbus contracts was lower than the value of BMN's pledge of the rights resulting from them. Therefore, according to the IA, BMN should have given its consent to the sale.
- (ii) There is no record that BMN consented to the sale of the BU. The fact that BMN did not expressly object to it cannot be deemed as a consent.
- (iii) When the insolvency court approved the sale of the BU, BMN was not ranked as a secured creditor and, thus, its consent was not requested. However, there was a pending appeal on the classification of BMN's claim and CITD was aware of that, as it was remarked in the court's order approving the sale.
- (iv) CITD had no right to acquire the BU without collateral unless consented by the secured creditors. As BMN's pledge was ultimately recognised in the insolvency proceeding and CITD knew this could happen when it acquired the BU, BMN is entitled to enforce the pledge.

This SC judgment shows the importance of the principle of good faith in the interpretation and performance of contracts; in this case, of those entered into in relation to the liquidation of a company under insolvency proceedings.