# International Corporate Rescue

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ARTICLE

# 'Compensatory Advantages' and Avoidance Powers in the Insolvency of a Company that Gives an Intra-Group Guarantee: Spanish Experience

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## I. Introduction and previous legal doctrine

As in other jurisdictions, Spanish law has long faced the problem of the validity and enforcement of intra-group guarantees, where the grantor, subsidiary company, has become insolvent afterwards. The same topics are constantly discussed: is the granting of the guarantee an act of disposal without consideration as regards the beneficiary group company? If the answer is in the negative, could it be contested as an act detrimental to the estate, positing the question *ex-ante* (at the time the guarantee was granted)? For some years after the enactment of the Spanish Insolvency Act ('IA') in 2003, courts hesitated as to the solution that these questions merited (see Supreme Court Judgments 791/2010 and 652/2012). In the end, one had the impression that almost every up-stream guarantee succumbed to the insolvency practitioner's avoidance powers and that courts generally upheld the validity of down-stream guarantees. This outcome reveals the counterfactual insight of legal scholars and legal doctrine as to the phenomenon of the group of companies, when refusing to take an overall approach to this theme. Besides, the decisions were justified without taking into account whether or not there were group external creditors to be protected and whether the avoidance of the transaction was the optimal way of providing such protection.

In addition to the first set of questions, there is the subsequent doubt as to whether the voidness of the security drags along the enforceability of the credit facility as such. If the answer is yes, we have the paradoxical consequence that the loan should be reimbursed by the estate as an expense-of-the-liquidation claim, beyond the rules that govern the payment of ordinary insolvency claims. In a confusing crisscrossing of argumentation, the final outcome in courts has been the postulate that the avoidance does not extend to the credit facility opened in favour of the parent company,[1] though there were court rulings defending the dragging of the credit facility by the avoidance of the collateral transaction, for instance the rulings of the Companies Courts of Oviedo, 18 February 2010, and Barcelona, 1 February 2012. We cannot delve deeper into this last matter in the present paper.[2]

## II. The Supreme Court Judgment 100/2014

The Supreme Court Judgment 100/2014 set out the rule currently in force. According to its terms: (1) A guarantee or security granted at the time (contextual granting) the credit facility was made available to the other group company should be presumed a transaction for consideration, in spite of the grantor not getting any formal consideration and without the need to prove that the facility will also be available for the grantor's own business financing; focusing on the creditor's position, the Court stated that the credit facility would not be given when the financier could not take the guarantee as consideration for the credit facility. (2) Notwithstanding the aforementioned rule, the transaction is not insolvency-proof by the mere characterization as 'for consideration'; the *detriment test* should further be applied, according to which the security giver must not suffer an unjustified sacrifice. (3) Such a sacrifice is deemed to occur when the grantor receives no financial benefit or advantage, albeit indirect; in other words, when there is no *compensatory advantage* in favour of the subsidiary. (4) The mere *interest of the group as a whole*, though existing in fact, does not amount to a compensatory advantage, even where the group's benefit surpasses the subsidiary's non-compensated detriment.

Notes

1 Judgment of the Supreme Court 100/2014; Judgment of the *Audiencia Provincial* of Madrid (Twenty-eighth Chamber) of 1 March 2013; and Judgments of the *Audiencia Provincial* of Asturias (First Chamber) of 14 and 15 March 2012.

2 A. Carrasco, *Rescindibilidad concursal de garantía simultánea por deuda ajena*, Westlaw-Aranzadi BIB 2012/3300; F. Curiel, 'Los efectos de la acción de reintegración en el concurso', in J.A. García Cruces (ed.), *La reintegración en el concurso de acreedores* (2nd edn, Thomson Reuters 2014), 231-233.

No less. But also no more. In fact the core of the incertitude seems to have switched from the question of the gratuity to the new topic of the compensatory advantage. Although the gratuitous nature of the transaction is an irrefutable presumption of detriment (Article 71(2) IA), not too much is gained when, free from this presumption, the transaction can also be avoided due to the effective (not presumed) detriment (Article 71(1) IA), flowing from the fact that the subsidiary in fact did not gain any advantage for itself, that is that the transaction is proved gratuitous even though the presumption does not operate. Is there any difference between these situations? Can one conclude the existence of this advantage when ex-hypothesis the guarantor has not received any direct compensation and, for it to be affirmed, the overall interest of the group does not suffice? Inevitably this situation leads to a case-by-case approach in which the financier bears the burden of proof and gains nothing from saying that, in general, contextual guarantees and collateral provisions are transactions for consideration.

The topic of 'compensatory advantage' not only matters in issues related to insolvency avoidance powers. In other corporate contexts, the Supreme Court has developed the concept of compensatory advantage in order to find the limits of directors' discretionary powers – and corporate liability as a cause of action – when they pass company resolutions which may be detrimental to the business interests of the subsidiary whilst furthering the overall interests of the group, which is embodied in the interests of the parent company (Supreme Court Judgment 695/2015).

Be that as it may, the truth is that the ruling of Judgment 100/2014 has been upheld, without further changes, by subsequent Supreme Court Judgments 289/2015, 290/2015, 294/2015 and 295/2015. The only qualification made by these new ruling consists in the postulate that in a down-stream guarantee it is presumed that the dominant shareholder profits from the advantage of the credit facility flowing up from the secured subsidiary in the form of dividends, buy-backs, remuneration or otherwise.

## III. Compensatory advantages in lower courts

Before moving on to the more recent case law of the Supreme Court it is advisable to explain in which company group situations the lower courts (Provincial Appellate Courts) have deemed a compensatory advantage to exist.

(1) Existence of strong interrelations between the companies, which entails the subsidiary wholly depending on the parent company, especially when the owner company is the sole or main client of the guarantor (Baleares, 17 April 2013; and Zaragoza, 23 June 2015).

(2) Existence of financial support by the parent company, directly or indirectly, especially in the form of down-stream guarantees (Vizcaya, 2 January 2014; Baleares, 24 December 2014; Asturias, 31 March and 4 April 2014).

(3) When the subsidiary has a company object that is supplementary to that of the parent company, which is, in itself, essential to the subsistence of the subsidiary (Coruña, 3 February 2014).

(4) When the guarantee that is granted enables the continuance of a commercial relationship with an essential supplier whose involvement is paramount to the whole group (Baleares, 21 January 2014).

(5) When the group functions in practice under commingling accounts and there is continuous and reciprocal flux of monies (Murcia, 7 May 2015).

## IV. The new approach in the Supreme Court

The Supreme Court Judgments 213/2017, 404/2017 and 406/2017 add a new milestone to the body of legal doctrine concerning intra-group guarantees. The subsidiary (MECSA) granted to Liberbank a mortgage that was contextual to the credit facility made available by the bank to the parent company (TAS). The overlapping calendars of the credit facility and of the security leads to the conclusion that the latter is not a transaction without consideration, especially where the granting of a subsidiary mortgage was required by the bank as a condition for the credit facility. However, to uphold the security as not detrimental (not as for consideration) it must be verified whether the subsidiary received any financial consideration or any indirect advantage benefiting its business. In the words of the court,

> '[T]he grant of the mortgage is justified by the reciprocal guarantees which the parent company offered and continues to offer with the purpose of enabling MECSA to access external financing. The compensatory advantage lies in that through the giving of collateral TAS made possible MECSA's external credit facilities.'

In conclusion, the present/past existence of crossed and reciprocal support inside the group through sureties or collateral amounts to a compensatory advantage received by the insolvent company, which bars avoidance of the transaction under consideration.

## V. Commentary

The authoritative proposition set forth in these judgments seems unsound. A lot of further questions remain to be considered beyond the mere historic existence of any kind of cross support between the companies.


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First, it is questionable whether it is required that the reciprocal support should be deemed as interconnected for each reciprocal support to amount to *consideration* for the guarantee or collateralization granted by the other company. This requirement would call for a short length of time inside which the reciprocal transactions must have happened. If the aforementioned requirement is dispensed with, it is still advisable to discuss whether there is or is not a maximum length of time in which the reciprocal transaction should have occurred. If we also make do without this second requirement, it would be difficult to find any sort of mutual intra-group undertaking that cannot comply with the pattern illustrated in the above-mentioned judgments, because it would be difficult to isolate a group of companies that in the course of time have had no economic and business transfers or some kind of cover between them. Thirdly, it has to be presumed that the amount of each reciprocal support also matters. Cross-collateralization, for instance, less than ten times the amount of the guarantee given by the insolvent company and challenged in avoidance proceedings, probably does not suffice as true indirect consideration for the subsidiary's sacrifice. Finally, other technical points remain to be considered. For instance, whether the delivering of one or more comfort letters by the parent company suffices for establishing that a guarantee or collateral has been provided; also, there isdoubt as to whether the joint entering into a debt as co-debtors has to be considered as a surety given by the supporting company. Finally, there is the question as to whether the collateral provided for the benefit of an insider creditor has the same significance as collateral granted to an outsider bank.


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