

MADRID

Castellana, 216
28046 Madrid
Tel.: (34) 91 582 91 00

BARCELONA

Diagonal, 640 bis
08017 Barcelona
Tel.: (34) 93 415 74 00

BILBAO

Alameda Recalde, 36
48009 Bilbao
Tel.: (34) 94 415 70 15

MALAGA

Marqués de Larios, 3
29015 Málaga
Tel.: (34) 952 12 00 51

VALENCIA

Gran Vía Marqués
del Turia, 49
46005 Valencia
Tel.: (34) 96 351 38 35

VIGO

Colón, 36
36201 Vigo
Tel.: (34) 986 44 33 80

BRUSSELS

Avenue Louise, 267
1050 Bruselas
Tel.: (322) 231 12 20

LONDON

Five Kings House
1 Queen Street Place
EC 4R 1QS Londres
Tel.: +44 (0) 20 7329 5407

LISBON

Avenida da Liberdade, 131
1250-140 Lisboa
Tel.: (351) 213 408 600

INSOLVENCY STAYS ON ENFORCEMENT OF SECURITY ON INVENTORY ON THE RULING OF COMMERCIAL COURT NO. 6 OF MADRID DATED 30 JANUARY 2012

Fermín Garbayo
Partner Gómez Acebo & Pombo, Madrid/Lisbon

Expedited enforcement and foreclosure is critical to secured creditors seeking recovery of debts, but Spanish insolvency law may impose limitations and restrictions on enforcement proceedings which need to be carefully considered as part of the risk analysis for each transaction. It is however not only the actual legal texts that matter as associated case law is capable of generating uncertainties in apparently clear legal provisions.

This court ruling is a clear example of this.

The case: A creditor is pursuing the enforcement of a mortgage on a real estate asset of the debtor. The corporate purpose of the debtor is the development and construction of houses and the building at stake is the only asset in its balance sheet at that point in time. The debtor had filed for insolvency prior to the completion of the enforcement process.

In order to resume the execution of the mortgage, the secured creditor requests from the commercial court dealing with the insolvency proceedings of the debtor, a declaration that the asset is not attached to the entrepreneurial or economic activity of the debtor and hence not subject to the stays provided for in article 56 of the Spanish Insolvency Act.

The law applicable: Article 56 of the Spanish Insolvency Act:

Article 56. Stay on enforcement proceedings of security arrangements and equivalent recovery proceedings

1. *Creditors holding security on assets of the insolvent debtor attached to its professional or entrepreneurial activity or to that of one of its production units shall not be allowed to commence enforcement or realization proceedings until a composition of creditors the content of which does not impair such enforcement has been approved or the liquidation phase of the insolvency proceedings have not been opened within one year from the declaration of insolvency.*

[...]

2. *The enforcement proceedings referred to in the previous paragraph shall be suspended as from the date on which the declaration of insolvency has been recorded in such proceedings, regardless of whether or not the auction of the asset or right has been announced. This suspension shall only be raised and the enforcement resumed upon receipt and recording in the enforcement proceedings of a testimony of the insolvency judge's order declaring that the assets or rights are neither attached nor necessary for the continuation of the professional or entrepreneurial activity of the debtor.*

The court judgement: The judge understands that the reference contained in article 56.1 to assets attached to the professional or entrepreneurial activity of the debtor and hence the scope of the stay on enforcement ought to

be construed in light of (i) paragraph 2 of that same article which allows for the resumption of the enforcement proceedings upon declaration by the judge that such assets are *neither attached nor necessary for the continuation of the professional or entrepreneurial activity of the debtor* and (ii) article 44.1 of the Spanish Insolvency Law that provides for the continuation of the activity of the debtor notwithstanding the declaration of insolvency.

Commercial Court nº. 6 of Madrid accepts the position in this respect maintained by other Commercial Courts and Tribunals of Appeal¹ of expanding the scope of the stay to include not only the assets directly devoted to the production and manufacturing processes of the debtor (manufacturing machinery, tools and equipment), but also those goods or assets manufactured or produced by the company. That is to say, those assets held by the debtor with the purpose of being sold in the ordinary course of business (the inventory) which, from an accountancy perspective, in the case of construction companies, are the dwellings built to be sold.

This is however a matter still under debate as other Tribunals of appeal² have maintained a restrictive approach as to what should be the reach of the enforcement stay, circumscribing its application to security arrangements on

assets of the company devoted permanently to providing services or manufacturing goods, and hence excluding inventory precisely on the grounds that inventory is made up of assets which are ultimately destined to be sold³. These judgments clarify that the stay should only affect enforcement proceedings on production means, that is to say, the assets that are required for the production or manufacturing processes.

Other decisions have dealt with this topic in a more subtle way excluding inventory (completed assets to be sold) from the stay but not the raw materials and parts still undergoing the manufacturing or construction process⁴.

Bearing in mind the discrepancies of Spanish courts and the important implications for creditors in this matter, it shall be for the Spanish Supreme Court to establish what is the ultimate objective and scope of article 56 of the Spanish Insolvency Act, and hence the scope of the stay on enforcement: either (i) the protection of the production means of the debtor only, as implied in the more restrictive court rulings, or (ii) in the more expansive resolutions, the preservation of the capacity to operate in the market, including the means which enable the debtor to generate cash in the ordinary course of business.

¹ Resolution of the Provincial Court of Alicante, Section 8, dated 18.12.2009.

² Resolution of the Provincial Court of Las Palmas, Section 4, dated 12.01.2006 and of the Commercial Court of Barcelona n. 8, dated 19 July 2011.

³ Therefore the enforcement of security on these assets should not jeopardize the continuation of the activity of the company.

⁴ Resolution of the Commercial Court of Barcelona n. 8, dated 17 April 2009.