Some operating rules concerning pledges of future claims in insolvency proceedings

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The amendment to art. 90(1)(6) of the Insolvency Act 22/2003 (abbrev. LCON) by the Public Sector (Legal Regime) Act 40/2015 was welcomed almost enthusiastically by most market agents. It was felt that the inconsistent treatment bestowed on pledges of future claims (hereinafter, 'PFC') would finally be a thing of the past. I myself am not altogether convinced that this is the case, being able to envisage more than one way an insolvency judge, averse to this type of security interests, can dampen the aforementioned enthusiasm by way of a not overly absurd interpretation of the new provision. Nonetheless, such is not the subject matter of this briefing note, nor is it an interpretation of the scope of the text introduced by Act 40/2015. The following thoughts focus on the operational side of matters and are intended to be independent of whatever interpretation is given to art. 90(1)(6) LCON.

1. Regardless of whether or not a PFC is enforceable in insolvency proceedings, it may still be the subject of a claim for avoidance (clawback) under art. 71 LCON, to the extent that the creation or scope of the same involves a "detrimental act" for the insolvency proceedings. This has been recalled in the judgment of the Supreme Court of 24 June 2015, making this observation in terms that makes it seem that all PFC are classifiable as a detrimental act. This situation would render sterile any debate on the interpretation and scope of art. 90(1)(6) LCON, at least for a PFC given up to two years prior to insolvency proceedings. Deep down, a comparison with the circumstances envisaged in art. 71(3)(2) LCON is tempting: it is as if a security interest were being granted as collateral of a pre-existing claim. Without delving any further into this right now, a PFC would only be safe if in the agreement creating the security interest the creditor is required to *subsequently* provide some sort of new value in connection with the continued pledge. The threat is much stronger for "pure" future claims, that is, those which, according to a plausible interpretation, could only be encumbered by way of a non-possessory pledge (hereinafter, 'NPP') registered with the Chattels Register.

2. A PFC hypothetically resting on "pure" future claims and even future claims deriving (though yet unborn) from a "pre-existing legal relationship" or an agreement subject to a condition precedent, etc., would be a security interest of no "security value" for the purposes of arts. 90(3), 94(5), 149(2)(a) and relevant provisions LCON, because there would not be an underlying reference asset. Among other consequences of this situation, the pledgee would not receive more money in a liquidation than that which would apply in respect of any junior unsecured creditor. To the extent it affects claims unborn at the time of liquidation, said liquidation "destroys" the security, rather than serving to repay the claim and for which the security was taken in the first place. In other words, a prospective or contingent security interest has no "security value" for the appropriate insolvency purposes, especially at the time of liquidation.

3. However, if the transferee of the production unit assumes the whole position of the insolvent grantor [art. 149(2)(b) LCON], the same would apply with regard to any encumbrance over future claims which arises from the subsequent

operation of the business in question, and the obligation to generate these future resources would necessarily be shifted to the transferee, despite the wording of art. 146 bis (4) LCON.

4. A PFC can become a pledge agreement that in turn meets the conditions to become an agreement that generates reciprocal pledgor-debtor and creditor-pledgee claims ("executory contract"), claims that may remain mutually unfulfilled upon the opening of insolvency proceedings, within the meaning of art. 61(2) LCON. For a PFC this means an additional strength, since subsequent defaults of the pledgor debtor can be processed as expenses of the liquidation, but also an additional weakness, because the insolvency practitioners can terminate the agreement in the interests of the insolvency proceedings, thereby eliminating the security interest.

5. With the debtor going into liquidation, any obligation the insolvent pledgor might have contracted of continuing to generate claims against third parties, covered by the PFC, is left without substance and value. This "default" would neither generate any type of debt, be it as expenses of the liquidation or as unsecured liabilities, nor give rise to a cause of action for termination by breach (art. 62 LCON).

6. The project account in which the funds are deposited must always be pledged. It is very likely that this security interest deserves the status of "financial collateral", with all that this means for the purposes of Royal Decree-Act 5/2005 on urgent reforms to boost productivity and improve public procurement. And to avoid the contention that the future balances did not exist at the time of the insolvency proceedings, the PFC can be given as a NPP resting on the account *as a whole*.

7. A PFC is not a framework agreement, but an agreement under which a pledge is given of goods that are to be in the future (security interest carried back to the time of giving of the pledge). Hence, it is not necessary for future claims born after the giving of the pledge that they be the subject matter of *special registration*. In this regard, the legal doctrine laid down by the Decision of the Directorate-General for Registers and Notaries of 5 June 2012, concerning the retention of ownership of vehicles held as a whole by the debtor in stock and for resale, must govern by analogy.

8. Any PFC must specify a maximum cover of the claims to be born in the future, and include a clause releasing from successive future claims that exceed the amount of cover. Although it is not clear that this requirement is imposed by our non-insolvency law, it is preferable to guard oneself against an accusation of "over-collateralisation" (for instance, judgment of the Supreme Court of 17 February 2015).

9. A PCF may be a security interest derived from a previous security interest over tangible assets, for which the (future) claim turns out to be proceeds. For instance, the extension of the mortgage to the proceeds of the thing or *res* (the claims can be income from the property) or to the compensatory claims for damage caused to the mortgaged property. The temporary priority in the granting of the security (mortgage or PFC) governs in this respect. An unregistered PFC could not be relied on against a PFC embedded in a clause extending the registered mortgage, be it prior or subsequent to the unregistered PFC.

10. For an effective pledge cover, it does not suffice that "the claims are born from perfected agreements or legal relationships created before the opening" of insolvency proceedings [art. 90(1)(6)(a) LCON]. In accordance with the *ius commune* tradition, property cannot be removed retroactively from the insolvency estate if it is an asset whose production would require an act of the debtor-pledgor characterized as an act of a *discretionary* nature, regardless of a pre-existing "legal relationship".

11. The referral made in art. 90(1)(6)(c) LCON to art. 261(3) of the Public Contracts Act proves that a (future) claim can be regarded as the cornerstone of a "pre-existing legal relationship" even if its birth or pledgeability nonetheless depended on the decision, even if discretionary, of a *third* party.

12. The "legal relationship created before" is the legal relationship with the third-party debtor, the debtor of the claim that is the subject of early pledging. A legal relationship between the pledgor and the creditor or between the pledgor and another third party does not suffice. Thus, charges or tariffs payable by future users are not a claim "born" of the legal relationship (already created, perhaps) consisting of the concession of services

or public works granted to the debtor and eventually funded by the creditors holding such PFC.

13. The "legal relationship created before" must continue to exist at the time of the insolvency proceedings. If terminated at that time, but renewed after the insolvency proceedings, the future claim does not meet the condition required by art. 90(1)(6)(a). A contract with a third party, already consummated at the time of the opening of insolvency proceedings, does not generate, like a halo, a "legal relationship" that could thereby be regarded as subsisting at the time of such opening.

14. If the PFC were to be given before the suspect period of two years prior to the aforementioned opening, all of the pledge would be safe from clawback, *including charges over each of the claims pledged* as far as they come into existence, even when born within the suspect period prior to the opening of insolvency proceedings. Notwithstanding the foregoing, certain court decisions concerning similar cases (a main agreement that generates successive acts of enforcement of rights or obligations under said agreement) point to the possibility that if the hypothesis here considered were to present itself, the solution given by the courts could very well be different to that suggested here.