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## REDEMPTION OF UNRELATED THIRD PARTY DEBTS AND REIMBURSEMENT RIGHT OF THE PAYOR

SPANISH SUPREME COURT RESOLUTION 339/2011, DATED MAY 26 2011

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**Introduction:** The transfer of debt in any of its multiple forms, whether by means of assignment, novation, subrogation or otherwise, has been (and remains) a matter of major importance for financial institutions and hedge funds throughout the entire financial crisis.

Topics such as the implications of the assignment or novation in the case of the insolvency of the assigned debtor, debt restructuring post acquisition, clawback provisions and hardening periods in the applicable insolvency regulations, the impact of the assignment technique used on the security package and other rights associated with the assigned debt have been discussed at length in the context of distressed or non performing debt transactions.

Nevertheless, more subtle issues remain outside of the centre of focus of professional purchasers of receivables. In the following paragraphs we shall briefly discuss one of these issues, namely, the legal consequences of the redemption of debts by unrelated third parties in light of the recent Spanish Supreme Court Resolution 339/2011, dated May 26 2011.

**The case:** In the case at hand, Company A, a company specifically incorporated with the purpose of paying third party debts, pays the amounts owed by Company B to three different creditors (a Spanish municipality, the Spanish social security authority and the Spanish tax revenue authority). Company B only learns about this payment by Company A at the time the latter files a claim for reim-

bursement of such amounts. Both companies are Spanish. It later transpires, that the aim of Company A was to enforce the debt against Company B and specifically, to seize and appropriate certain real estate assets of the latter at a low price.

**The applicable law:** Article 1.158 of the Spanish Civil Code:

*Payment may be made by anyone, whether or not holding an interest in the fulfillment of the obligation and whether or not the debtor knows and agrees to or ignores such payment.*

*He that pays a debt for the account of a third party may claim from the debtor the amount paid unless payment had been made against the express will of the debtor in which case the payer shall only hold a claim for the actual advantage produced in the debtor by such payment.*

**The arguments of the claim (essentially, those of Company B):**

The payments of Company A were made against the express will of Company B as manifested after the claim for reimbursement was brought by Company A and therefore only payment of the actual advantage of Company B (as opposed to the full amount paid by Company A) can be sought.

The payments of Company A not only did not generate any advantage to Company B but

rather were the origin of the latter's insolvency as frustrated any renegotiation or settlement possibilities that Company B would have had with the original creditors.

The conduct of Company A is in breach of the principle of good faith and jeopardizes social harmonic co-existence. It also fulfils the objective and subjective requirements of the abuse of right, namely: (i) intent of causing damage, and (ii) excess and abnormal use of such a right.

The court resolution:

Since paragraph 1 of Article 1.158 of the Spanish Civil code allows for the payment of third party debts including in circumstances where the debtor ignored such a payment, it transpires that the express rejection by Company B, of the intended payment by Company A of the debts of Company B should have been expressed, in order to produce the effects depicted in paragraph 2 of said article, prior to or at least simultaneously with the payment but not after such payment had been made.

The general expectation to achieve a beneficial settlement with the original creditors cannot operate as an impediment to the acqui-

sition of third party debts, as this possibility persists with the new creditor.

The incorporation of a company with the aim of acquiring third party debts cannot be considered illegal, illegitimate or antisocial in itself as it is evident that the legal doctrine permits payments by an unsecured creditor of a secured debt against the same debtor in order to release the security on the encumbered asset and enforce the debt on that very same asset.

The advantage mentioned in Article 1.158 of the Spanish Civil Code should be understood as the patrimonial increase sustained by the debtor as a consequence of the reduction of the liability side of its balance sheet resulting from the payment of the debt.

It is implicit in the regulation contained in the Spanish Civil Code with respect to subjects such as (i) payments for the account of third parties (ii) third party subrogation in the rights of a creditor and (iii) assignment of debts; the legal legitimacy of the potential upside of the payer of third party debts, namely, that implicit in the full recovery of accounts receivable purchased at a price below its nominal value<sup>1</sup>.

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<sup>1</sup> This important conclusion (and indeed of the utmost importance in cases of distressed debt and non performing transactions), is however not part of the court ruling but is merely included "*obiter dictum*" as a reinforcement argument of the actual conclusions of the case.