Subrogation in contracts tied to the sale of productive units under insolvency proceedings

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The rule

Art. 146 bis of the Spanish *Insolvency Act* (hereinafter, IA) - incorporated by Royal Decree-Act 11/2014 - provides that if productive units are transferred on liquidation, the person acquiring the same will be assigned the rights and obligations arising from contracts tied to the continuity of the business or professional activity "where termination of such contracts has not been requested". The acquirer shall be placed, by way of subrogation, in the insolvent's contractual position without the need for consent of the other party.

The provision contains other important rules regarding contractual succession in public contracts and administrative authorisations. This paper does not discuss these two cases, despite their obvious importance

Comments

1. **At any stage of the insolvency proceedings.** Subrogation in contracts tied to the productive unit will occur not only at the liquidation stage, but also in the sale at the common stage, even before the existence of the composition and the liquidation plan (art. 43 *in fine*). It also applies if the transfer takes place as content of the composition with creditors (art. 100(2)). But in this case, the effect of subrogation will only be triggered if such is contained in the composition with creditors and has been approved with said content pursuant to arts. 124 and 134 IA; otherwise, the creditors of the insolvent will not have to accept the subrogation. I believe that the creditors of the insolvent which are a counterparty to contracts that could be affected by art. 146 bis IA, are not a "class" of creditors for the purpose of obtaining the special consent under art. 125 IA.

2. **No right of objection.** It is obvious that, unlike what is provided in arts. 44, 73 and 80 of the *Structural Modifications of Commercial Companies Act 3/2009*, the counterparty to a contract that may be subject to subrogation cannot require adequate guarantees that the contract will be fulfilled by the new obligor or otherwise object to the contractual subrogation. Without prejudice to what is said below.

3. **Assumption of contract and termination for previous breaches.** The acquirer of the productive unit does not assume debts prior to the transfer, as expressly provided in art. 146 bis (4) IA, except for those related to employment in the terms of art. 149(2) IA. But it is clear that the contractual counterparty may terminate for breach of pre-existing obligations of the insolvent, whether or not assumed by the acquirer, and that this termination may be declared against the acquirer which did not subrogate to the debt; regardless of whether it is or not debt against the asset pool. This statement is obvious, because it corresponds to the civil law rule of contract [for example, despite the contract assignment *ex lege* (as a matter of law) under art. 32 of the Spanish *Urban Tenancy Act* (hereinafter, UTA), the lessor can terminate against the new lessee for previous unpaid debt]. This is more clearly confirmed by art. 66 of Royal Decree-Act 9/2009, which regulates the effects of the obligatory transfer of assets imposed by the Spanish bad bank FROB on intervened or resolved financial institutions, and which allows

the termination of awarded contracts, including for breaches prior to intervention.

4. **No abuse of rights.** The above argument must prevail even when involving the non-payment of a (prior) debt which the creditor counterparty could not have recovered nor can it recover with the liquidation of the debtor's assets; i.e., even in the event of "zero liquidating dividend" on insolvency. It will be argued that there is an abuse of rights when there is termination against B for a debt that could not actually be recovered from debtor A. But there is no abuse. The creditor, contractual counterparty to an insolvent debtor, loses the value of its claim by virtue of the insolvency regime, but it would also be a disproportionate sacrifice if it also lost the opportunity to reject the continuation of a contract whereof defaults have not been remedied.

5. **Terminating compensation.** But the counterparty may not obtain from the acquirer any amount as compensation for damage or loss resulting from breaches preceding the transfer, because then it would actually produce subrogation to the existing debt, rejected by the IA.

6. **Ancillary effects related to subrogation.** The contractual subrogation under art. 146 bis IA does not prevent the ancillary legal consequences that sector-specific rules determine as effects of a contractual assignment *ex lege*. For instance, a rental increase in the case of art. 32 UTA. The same goes for contractually agreed effects associated with subrogation, if, for example, the contract included an increase in consideration agreed for any kind of subrogation allowed by the contract. The acquirer may always refuse to subrogate in a contract of this kind, but a supplemental contractual sacrifice may not be imposed on the creditor counterparty.

7. **Non-extension to other grounds of termination.** Art. 146 bis IA merely rejects that the counterparty may terminate the contract by the mere fact that legal subrogation occurs. That is, a non-consented change of contractual debtor does not constitute a "breach" or an alteration of the contract such that the counterparty may terminate for this reason. But the Act does not exclude nor can it exclude a termination of the contract tied to the productive unit for reasons other than mere non-consented subrogation. I have already referred to the case of breaches *prior* to the transfer of the productive unit, which have not been remedied by the debtor or the insolvency administration. But there are others.

8. **Change of control or exclusivity clauses.** Thus, the express termination clause consisting of the *change in control* of the insolvent debtor counterparty, or the termination or expiration clause consisting of the impossibility of maintaining contractual information confidential. Or other termination clauses connected to exclusivity covenants in distribution or licence agreements.

9. **Already terminated contracts.** Subrogation does not occur in bilateral contracts which have already been terminated by the creditor counterparty prior to the award of a productive unit to a third party.

10. **Non-restoration of claims.** Art. 146 bis IA does not contain a "restoration" of due (and outstanding) claims. In other words, the subrogation of the acquirer does not involve the addition of a new grace period or a novation of the compliance date.

11. **Non-application of arts. 61 and 62 IA.** We believe that termination of the subrogated contract, where appropriate, is not subject to the restrictions of arts. 61 and 62 IA. That is, termination may occur even in contractual relationships where the power to terminate has been restricted or cancelled pursuant to these provisions.

12. **The counterparty may not be obligated to grant credit to the subrogee.** No subrogation in contracts that have not been entirely fulfilled may produce a result whereby the counterparty has to grant or maintain a line of credit for the subrogee.

13. **Supplementary guarantees.** For the remainder of outstanding consideration, the exception of art. 1467 of the Spanish Civil Code prevails, and the counterparty may refuse to provide consideration to the acquirer if the former has grounds to believe that the latter shall not have the required solvency to meet its obligations, unless adequate security is given.

14. **Security in rem of the counterparty.** If the counterparty to the contract has security in the transferred assets, it can enforce it for fulfilment of previous or subsequent claims against the subrogee. For example, subrogation in the position of the lessee in financial lease agreements, the lessor enjoying the privilege of art. 90 IA.

15. **Defences of the counterparty.** If subrogation has not been consented to by the creditor counterparty, it may plead against the subrogee all defences that existed prior to the transfer, by analogy with art. 1198 of the Civil Code. The creditor counterparty may even plead as a defence a prior breach of contract, even if involving obligations that have remained with the insolvent by reason of art. 146 bis!