Temi e dibattiti di attualità

Financing and payments made by persons closely related to the debtor under articles 12 and 9.3 Royal Decree Law 16/2020

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ABSTRACT

Spanish Royal Decree-Law 16/ 2020 provides a set of rules of an exceptional nature whose purpose is to define measures to mitigate the impact of the COVID-19 health crisis on struggling businesses. Temporary rules are established to remove certain impediments that may prevent the persons closely related to the debtor from financing her professional or business activity. Specific provisions define how financing provided by persons closely related to the debtor is to be ranked if the beneficiary becomes insolvent and files for bankruptcy. Certain rules intend to facilitate the reaching of composition agreements or renegotiations involving specially related persons.

***Keywords**: bankruptcy – COVID-19 health crisis – ranking of insolvency creditors – persons closely related to the debtor*

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An immediate problem posed by the current economic crisis resulting from

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the health pandemic is the urgent need of businesspersons for financing and liquidity. The temporary cessation of their business activity, as a result of the quarantine, has led to a drain on their cash flows, that, along with the continuity of expenses, has resulted in a radical reduction of their income.

To deal with this issue, the search for financing sources to maintain business activity is a necessity that each and every business has to face and this notwithstanding the fact that maintenance of the business activity has been partially subsidized through public resources (this last with no recorded success so far). In this attempt to preserve business activity, and to prevent insolvency and bankruptcy, any source of financing is valuable irrespective of whom may provide for it. On this regard it must be considered that in a near to insolvency scenario, those who are to finance struggling businesses bear in mind how their claims are to be dealt with if filing for bankruptcy finally takes place.

Among the various sources of financing available to struggling business persons the possibility of reaching those who are closer to them becomes quite real. These people are not only linked to the business person on a business/family bases, but, in many cases also have a very direct and deep interest in helping in the continuity of the debtor's business activity. This is the case, for instance, of business company's members and directors, as well as, where appropriate, of the other companies that belong to the same group. All these may provide, if they deem it appropriate, further financing for a company undergoing financial turmoil. Similarly, and now for individual debtors financing might be provided by their relatives or, alternatively, by those companies under their control or by companies controlled by those persons to whom they are related to.

However, the debtor being financed by people close to her is extremely complicated as a result of certain burdens resulting out of provisions set in the Spanish Bankruptcy Law Consolidated Version (hereinafter, TRLCon [1]). In case of companies, both their members (under certain conditions), their directors and companies that belong to the same group as the company in need of financing when bankruptcy proceedings are opened are considered, *ministerio legis*, as persons especially related to the insolvent debtor (*personas especialmente relacionadas con el deudor*, article 283 TRLCon). In the case of the insolvent debtor being a natural person, her spouse, her ascendants, descendants and siblings, as well as all those legal entities under her control are also re-

[1] https://www.boe.es/buscar/act.php?id=BOE-A-2020-4859.

garded from a bankruptcy perspective as persons especially related to the debtor (article 282 TRLCon). [2]

The aforementioned labelling as a person especially related to the debtor implies that, in the event of the debtor becoming insolvent and filing for bankruptcy, the claims derived from the financing provided by those closely related to her persons will be reputed as subordinated claims (article 281.1.5 TRLCon), with all the statutory consequences provided for this rank of claims (deprivation of vote with regard to composing agreements *ex* article 352. 1 TRLCon, subordinated claimants are going to be bound by the composing agreement but the payment of their claims is postponed to the payment of ordinary credits – subordinated claims are the last to be paid – *ex* article 396.2 TRLCon. Where bankruptcy proceedings outcome is liquidation, it is the same. subordinated claims are to be paid once ordinary claims were but, moreover, subordinated claims held by those closely related to the debtor are in the fifth range of the subordinated claims ranked ex article 435 TRLCon. Thereto are to be paid once the subordinated claims belonging to the previous four ranges of subordinated claims are). [3]

Under the particular economic circumstances resulting from the COVID-19 crises, these bankruptcy rules turn out to be a very relevant impediment that prevents those closely related to the debtor from financing her.

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[2] The list of persons especially related to the debtor comprises those subjects who, either because of their family bounds to the debtor or because of their legal position within a given company, are more likely to be better informed and thereto aware of the debtor's economic situation or, even and more importantly, are in a situation where they may exercise a certain degree of control over the debtor (*insiders*). Nevertheless, through articles 282 and 283 of the TRLCon, the Spanish legislator has opted to establish a closed list of persons close to the debtor, which closes down those who deserve such status in the insolvency proceedings. The automatic deferral in payment subordinated credits are subject to prevents the judge from having to make further inquiries on the conduct of the insiders and having to assess the circumstances under which financing was granted to the debtor. Sentencia del Tribunal Supremo 10 October 2011(ECLI:ES:TS:2011:6633). J. Ferré Falcón *Los Créditos Subordinados*, Cizur Menor, Aranzadi, 2006, *passim*, A. Ávila De La Torre, "*Los créditos subordinados*", in *Las Claves de la Ley Concursal*, Cizur Menor, Aranzadi, 2006, 439 *et seq*., C. Alonso Ledesma, "*La reforma en materia de subordinación crediticia*" in *Revista de Derecho Concursal y Paraconcursal*, núm.11, 2009, 59 *et seq*.

[3] The rule for the payment of these subordinated credits is that set in article 435 TRLCon, which determines that the honoring of subordinated credits is deferred to payment of the credits against the estate and bankruptcy credits as such whether they are privileged or ordinary credits. Art. 281 TRLCon sets the order of payment to be followed regarding subordinated credits. A. Ávila De La Torre, "*El pago de los créditos ordinarios y subordinados en la liquidación concursal*", in *La Liquidación Concursal*, Cizur Menor, Civitas, 2011, 384.

2. *The response offered by Royal Decree Law 16/2020.*

In order to avoid the aforementioned inconveniences regarding financing provided by those closely related to the debtor in case she may become insolvent, article 12.1 of Royal Decree Law 16/2020 provides that the credits granted by these especially related to the struggling debtor will be ranked, if the latter's bankruptcy is ultimately declared, as ordinary claims [4]. This is to be so provided that these claims were born after the date on which the state of alert (*estado de alarma*) came into effect in Spain. This was March 14th. [5]

The rule broadly frames its objective scope – cash income from loans, credits or other businesses of a similar nature provided by persons closely related to the debtor are to be ranked as ordinary credits – in order to cover all forms of financing. However, this exceptional rule is limited in time, in the sense that it will only apply to those insolvency proceedings which are declared within two years of the date of the declaration of the state of alert.

Thereto the rule set by article 12.1 of Royal Decree Law 16/ 2020 provides a window of opportunity for companies members, shareholders, directors, companies belonging to the same group and other persons linked to the debtor to provide financing to business persons that are expected to struggle in the foreseeable economic crises to come after the COVID-19 pandemic. This rule is expected to contribute to solving legal entities and natural persons difficulties without those related to them being exposed whatsoever to the risks that in case the former financial struggles are not overcome and become insolvent the claims arising from the financing provided will be ranked as subordinated.

In short, the rules for ranking bankruptcy claims have been altered – temporarily and exceptionally – in order to favor intra-group financing and financing provided by persons especially related to struggling legal entities and natural persons, given that the claims resulting from such financing will be ranked as ordinary bankruptcy claims if the debtor at the end has to file for bankruptcy.

Given the urgent nature of the drafting of these notes, only two comments can now be made.

Firstly, and this is a common feature in Royal Decree-Law 16/2020 provisions, the setting of the *dies ad quem* for the deadline of the application of the rule we are now dealing with is that of the date of the debtor declaration of bankruptcy. That is, the ranking as ordinary claims of those claims that have

[4] https://www.boe.es/buscar/pdf/2020/BOE-A-2020-4705-consolidado.pdf.

[5] https://www.boe.es/boe/dias/2020/03/14/pdfs/BOE-A-2020-3692.pdf.

their origin in the financing provided by persons especially related to the bankrupt debtor relies on the declaration of bankruptcy being made before the expiry of the two-year period after the declaration of the state of alert (the declaration of the state of alarm was made on March 14th 2020).

This being the case, there is a risk that although the filing for bankruptcy may have been prepared in accordance with the system in force at the time of its presentation, the date of the declaration of bankruptcy by the competent Court may take place once the two-year period from the declaration of the state of alert has already been exceeded. If this is the case, bankruptcy proceedings would be subject to the general system set out in the TRLCon. This outcome may become a reality as a consequence of the Spanish Commercial Courts current overload of work, which will very probably be increased in the very near future. If this turns out to be the case, chances are that the person especially related to the bankrupt that had granted her credit expecting that if bankruptcy is ultimately declared her claim would be ranked as an ordinary one may find that this will not be the case if at last bankruptcy is declared after the expiry of the aforementioned two years after the end of the state of alarm period. This conclusion could be supported by the undoubted constitutive nature of the declaration of bankruptcy, as well as by the strict reference to that deadline resulting verbatim out of art. 12. 1 of Royal Decree Law 16/2020.

However, it seems to us that a correct interpretation of the general procedural rules which apply – also – to bankruptcy proceedings (art.521 TRLCon), should lead to a different conclusion [6]. From a procedural point of view *lis pendens* deploys its effects on all jurisdiction and procedural matters, but also on the material rules that must be applied. And this is so unless a provision expressly rules to the contrary. There for *lis pendens* results into a disruption of the material legal relationship between natural persons or legal entities once the filing of a lawsuit before the Court starts producing its effects. This is with the filing of the law suit, in our case the filing for bankruptcy, is later admitted (article 410 Ley de Enjuiciamiento Civil). [7]

For this reason, it is to be understood that, if the application for bankruptcy is presented within the aforementioned period of two years from the declaration of the state of alert, the credit derived from the financing provided by the persons especially related to the bankrupt party must be ranked as an ordinary claim in application of the provisions set in Royal Decree Law 16/ 2020. Even

[6] C. Senés, "*Derecho Procesal Supletorio (D.F.5ª)*", in Rojo, Beltrán *Comentario a la Ley Concursal*, II, Madrid, Civitas, 2004, 3122 *et seq*.

[7] J. Montero Aroca, *El Proceso Civil*, Valencia, Tirant lo Blanch, 2016, 902-903.

when bankruptcy declaration is made after the expiry of this period.

However, this provision of article 12.1 of Royal Decree Law 16/2020 leads to a second additional consequence. And this second consequence is one that will certainly contribute to favor the position of those closely related to the debtor that have financed her during her struggle in the two years following the declaration of the state of alarm due to COVID-19 health crises.

Under the general provisions of TRLCon if a claim in a bankruptcy proceeding happens to be ranked as a subordinated claim and this claim happens to be secured with a real guarantee, TRLCon provides for the cancellation of the guarantee (article 302.1 TRLCon).[8]

However, as a result of the exceptional legislation set by Royal Decree Law 16/ 2020, the rule set out in article 302.1TRLCon becomes unenforceable when the creditor is a person especially related to the bankrupt and her claims derive from the financing provided following the state of alarm declaration, as long as bankruptcy is declared within two years of this date. As we have seen under that scenario the claim is not ranked as subordinated but as an ordinary claim and, consequently, there is no cause for the *ministerio legis* extinction of the guarantee securing the claim. [9]

If the aforementioned is the case, not only the encumbrance on the property used as a collateral remains, but also the claim of the person closely related to the debtor that is secured with the aforementioned collateral is not ranked anymore as an ordinary claim but rather as a privileged claim (*crédito con privilegio especial*) in the terms provided for in article 270 TRLCon. It should not be forgotten that having a bankruptcy claim ranked as privileged ones results in isolating the encumbered right or assed securing the claim to give preferential satisfaction on them to the creditor. [10] Therefore, a privileged claim is

[8] On this provision, see Sentencia del Tribunal Supremo February 20th 2013 (ECLI:ES:TS:2013:3115).

[9] J.A. García-Cruces González in *Jornada virtual de Derecho Societario y Concursal*, May 7th 2020. Tirant lo Blanch.

[10] Privileged claims are those secured with a specific asset or right. Mainly claims secured by mortgages, chattel mortgages, and pledges. TRLCon also foresees the so-called claims that benefit from a general preference. These claims are to be paid after secured claims and in accordance to the statutory order set in art.432 TRLCon. On the ranking of claims see Sentencia del Tribunal Supremo May 21st 2015 (ECLI:ES:TS:2015:2058). J.Mª. Garrido, "*Créditos con privilegio especial (art.90)*", in Rojo, Beltrán, *Comentario a la Ley Concursal*, I, Madrid, Civitas, 2004, 1606 et seq. and from the same author "*Créditos con privilegio general (art.91)*", in Rojo, Beltrán *Comentario a la Ley Concursal I*, Madrid, Civitas, 2004, 1635 *et seq.*

nothing more than an ordinary credit with a priority over the rights and assets comprised in bankruptcy estate that are used as a collateral. This is so as the claim value not covered by the seizing of the rights and assets securing it are regarded as ordinary claims during bankruptcy proceedings (article 272 TRLCon). [11]

With the aim of favoring financing provided by persons especially related to the businessperson undergoing difficulties and not yet insolvent after the COVID-19 state of alarm, two further provision are established.

In this sense, Royal Decree Law 16/2020 also foresees those cases in which persons especially related to the struggling debtor undertake the payment of her due debts instead of her (on this regard a distinction can be made between those people closely related to the debtor that have become guarantors of hers, necessary guarantors, but it can be noted that persons specially related to the debtor may also step in on a voluntary basis when the debtor cannot honor her obligations). This payment by third parties of the due and payable debts owed by the struggling debtor is another type of financing that may be provided for by those who are closely related to her. In short, through these means, and provided that payments were made after the declaration of the state of alarm, the persons especially related to the debtor would have contributed to the debtor's striving to overcome the difficulties to keep her business. These third parties' payments would have a further consequence, as those who pay instead of the debtor would be subrogated in the credit they had paid (articles 1210 and 1838 Civil Code), thereto becoming themselves creditors of the debtor.

This subrogation to the creditors' rights against the struggling debtor by persons closely related to her would be prevented if, when insolvency is ultimately declared, the general rules laid down in the TRLCon were applied, given that – as indicated above – their claims against the would be ranked as subordinated.

In order to favor the subrogation to the rights of the creditors by persons especially related to the debtor in trouble, article 12.2 of Royal Decree Law 16/2020 with regard to the bankruptcies declared in the two years following the declaration of the state of alarm provides that the claims, whether ordinary or privileged, in which specially related persons have been subrogated to as a result of the payment, are to be ranked as ordinary claims. [12]

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[11] J.A. García-Cruces González, in *Jornada virtual de Derecho Societario y Concursal*, 7 de mayo 2020, Tirant lo Blanch.

[12] M. Zubiri De Salinas, "*Créditos ordinarios*", in Beltrán, García-Cruces *Enciclopedia de Derecho Concursal*, I, Cizur Menor, Aranzadi, 2012, 901 *et seq*.

The question arises, however, on whether or not the subrogation falling on secured claims should o should not retain the ranking as privileged claims. It must be borne in mind, on this regard, that as a result of the special provisions set in article 12.1 of Royal Decree Law claims held by the people closely related to the debtor are to be ranked as ordinary claims and in case these claims are secured they are to be ranked as privileged claims as stated above.

The wording of the rule set in article 12.2 of Royal Decree Law establishing the consequence of the payments of ordinary or privileged credits made by specially related persons instead of the bankrupt is clear. The wording of art. 12.2 of Royal Decree law 16/ 2020 excludes the possibility of the claim maintaining the privilege when the payment of a secured debt is made by a person specially related to the bankrupt. If this was the case, the person specially related to the bankrupt debtor subrogates to an ordinary claim irrespective of the fact that the claim was secured for the benefit of the original creditor.

Finally, the application of these exceptional rules set out in article 12 of Royal Decree Law 16/2020 must lead to a further consequence with regard to bankruptcies that are declared within two years of the declaration of the state of alert.

In this sense, given the fact that direct financing by persons closely related to the bankrupt may result in having their claims ranked as ordinary ones and, in some cases, as privileged claims as well those rules set out by article 284 TRLCon becomes inapplicable. Thus, when the person especially related to the bankrupt party transfers her credit right against the debtor to a third party, there is no need to apply the assumption that the new creditor must be regarded in a subsequent bankruptcy proceeding as a person specially related to the debtor and having her claim ranked as subordinated.

But under Royal Decree Law 16/2020 provisions another scenario affecting those closely related to the debtor is set yet. In this case in relation to those bankruptcy proceedings that are solved by means of an agreement between the debtor and her creditors. article 9.3 of Royal Decree Law 16/2020 provides that in the event of the failure of the debtor to comply with the terms out of the composition agreement or the amendments made to the composition agreement within the two years after the declaration of the state of alert, certain claims are to be considered as claims against the insolvency estate in the event that the liquidation of the debtor's estate ultimately takes place [13].

[13] Claims against the insolvency estate are those generated by the bankruptcy procedure itself (derived from the costs and legal expenses of bankruptcy proceedings and from the obligations arising during the bankruptcy proceedings or which are maintained after its declaration)

The claims that are worthy of being considered as claims against the insolvency estate in the above-mentioned scenario are those that are referred to in article 9.3 of Royal Decree Law 16/ 2020. This is fresh money provided to the debtor for the purpose of financing a payment and a viability plan under a composition agreement or its amendments. Claims arising from financing transactions which result in a real increase in the liquidity resources available for the debtor are to benefit of this provision and thereto ranked as claims against the insolvency estate in case liquidation operations are to take place after the failure in the compliance of the composition agreement or its amendments. Other financing forms that do not involve new cash inflows into the insolvency estate are not to be ranked as claims against the estate although resulting from the composition agreement or the amendment of a previous passed one. Withdrawals, conversion of liabilities into capital, deferrals and substitution of some obligations by other ones are not to be considered as fresh money inputs. [14]

If the composition agreements or its amendments fail to be complied with within two years after the declaration of the state of alert, claims arising from fresh money provided to the debtor in the context of a composition agreement or its amendments will therefore be ranked as claims against the insolvency estate in a subsequent liquidation. Among the beneficiaries of this provision are those persons especially related to the debtor who have provided a personal or a real guarantee to secure a credit that permitted the debtor having access to new cash income in order (article 9.3 of Royal Decree Law 16/2020; experience shows that it is quite foreseeable that banks will rarely provide fresh money on an unsecured basis to an insolvent debtor).

It must therefore be concluded that the Royal Decree Law 16/2020 has

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and those which the Law sets as such. The main feature of these claims against the estate are explained if one takes into account their non-bankruptcy nature and the functions they are called to perform. Thus, on the one hand, expenses generated by bankruptcy proceedings and the new obligations that arise after bankruptcy proceedings are open must be satisfied before any other claim against the debtor. Otherwise the bankrupt debtor would not be able to obtain credit since no one would be willing to finance an insolvent person or company if she had to compete with the other creditors to recover. Moreover, claims against the insolvency estate will be deducted out of the estate before bankruptcy claims are to be paid. See Sentencia del Tribunal Supremo June 24th 2014 (ECLI:ES:TS:2014:2483), E. BELTRÁN, *Las deudas de la masa*, Bolonia, Studia Albornotiana,1986, *passim* by the same author "Pago de créditos contra la masa (art. 154)" in ROJO, BELTRÁN, *Comentario a la Ley Concursal* II, Madrid, Civitas, 2004, 2439 *et seq*.

[14] A. DIAZ MORENO, "*Los efectos de los acuerdos de refinanciación en un posterior concurso*", ADCo núm 33, 2014, 169-170.

adopted a very decisive option to strengthen the composition agreement outcomes for bankruptcy proceedings already in their way once the state of alarm was declared. On this regard, attention may be drawn to the fact that according to article 704.3 TRLCon Fresh money provided by persons specially related to the debtor in the context of a refinancing agreement will not be regarded as claims against the insolvency estate but as subordinated claims. Thereto the incentives to provide fresh money to finance the viability plan out of a composition agreement resulting out of article 9.3 of Royal Decree Law 16/2020 are paramount (Although assets subject to a security interest cannot be affected by the claims of the creditors of the insolvency estate, as a general rule claims against the insolvency estate are paid as they fall due and will therefore be deducted from the insolvency estate before the distribution to the insolvency creditors begins, articles 245.2 y 429 TRLCon).

3. *Assessment of these rules.*

At this point, it is necessary an assessment of the new rules that govern financing provided by persons closely related to the struggling debtor due to the foreseeable economic crises resulting from the COVID 19 sanitary crises. And, to this end, it should not be forgotten that both articles 12 and 9.3 of Royal Decree-Law 16/2020 constitute, like the rest of the provisions set by the aforementioned Royal Decree-Law, rules of an exceptional nature, lacking an expansive force, with respect to which there is no room for analogical application and characterized by their temporary effects.

Notwithstanding this characterization, the rules are a correct response insofar as it is a useful instrument for trying to cover the financing needs of those who are/will be undergoing difficulties as a result of the economic crisis. In other words, the aim pursued is correct, since removing any burdens that may prevent those persons closely related to the debtor from financing and, therefore, maintaining her professional or business activity must be welcome.

It is a different matter if the rule, probably drafted with the urgency required by the current crisis situation, may incur in some unforeseen events that could lead to unexpected unwanted or, at least, questionable results. In this sense, and as an example of such results, we can refer to two examples.

Thus, the person especially related to the insolvent party may negotiate and acquire liabilities held by creditors of the employer in difficulty, so that the latter, in view of the situation of the debtor, decide to transfer the claims for an amount reduced in relation to their nominal value. In this way, and when the

insolvency proceedings are ultimately declared, the person specially related to that debtor will nevertheless have a liability for the full nominal amount of the acquired claim despite of the fact that she had paid a lower (or much lower) amount. The consequence will be, then, that this creditor, by having her credit ranked as an ordinary one, will have a voting power that is not proportional to the payment made to have the credit transferred, and will be able to adopt the decisions it seems appropriate and extend its effects to the rest of the ordinary and subordinate creditors when voting on a composition agreement.

On the other hand, and as a second example, it is possible that the application of the provisions of article 12.1 of Royal Decree Law 16/2020 will allow, if I may say so, the recovery of assets in favor of those persons who are close to the debtor when, in principle, they should be subject to the common satisfaction of all the creditors of the debtor. That is, since article 302.1 TRLCon is not applicable in cases of direct financing by those persons specially related to the debtor, given the classification of such claim as ordinary if a subsequent bankruptcy proceeding is open, when such credit was secured that claim will be ranked as a privileged one with all that the consequences attached to such ranking.

Regarding provisions set in article 9.3 of Royal Decree Law 16/2020, it must be noted that although the Spanish Government has opted to promote composition agreements that include a viability plan the Spanish experience shows that the composition agreement outcome of bankruptcy is, from a quantitative perspective, quite unusual. And this situation is not expected to change in the case of small and medium size business. Nevertheless, this provision may have an impact on bankruptcy proceedings of those "too big to fail" companies that are headed to bankruptcy due to the crises or whose composition agreements are to be renegotiated due to the crises. In any case, the fact that specially related persons such as companies within the group or major stock holders such as family offices or venture capital firms may end up holding against the insolvency estate claims if liquidation proceedings are open due to the failure of the composition agreement may end up resulting in the introduction of important transaction costs in the planning and voting of composition agreements or their amendments whatever is the case.