

Mercantile Courts of Catalonia's Conclusions Clarify Aspects of Production Unit Sales

Proceedings from the courts' seminar address some material uncertainties, but ambiguities — especially over Social Security — remain.

Catalonian Mercantile Courts recently held a seminar and reached a common understanding (the Conclusions) regarding, among other topics, current controversial insolvency issues related to the sale of production units. Notably, the seminar proceedings expressly state that the Conclusions do not pretend to impose on the Catalonian Mercantile Courts any specific doctrine. However, the courts have articulated their intent to respect the Conclusions — provided the Conclusions apply in the relevant case. Furthermore, the proceedings aim to present insolvency receivers with a reasonable legal solution to issues related to the stated sale of production units.

Background

As we anticipated in our previous [Client Alert regarding the latest reform to the Spanish Insolvency Law](#), the sales of production units (somewhat similar to pre-packs in the UK) are currently gaining momentum within insolvency proceedings (whether within the liquidation phase or not). Such sales are probably the most effective way to maximize the debtor's assets' proceeds of sale. However, the regulation of the sale of production units under Spanish Insolvency Law is scant and the regulatory procedure remains unclear, in particular, as to whether the subrogation of Social Security claims is mandatory or not. As the court rulings on this matter have been contradictory and the consequences may be quite material, we had been expecting a clarification in this regard. The rules detailed in the Conclusion, as described below, provide some of that clarification.

Rules to consider

The Conclusions set out that sales of production units will continue to have a place in the Spanish insolvency landscape because they:

- Preserve jobs
- Maintain the business activity
- Optimize the value of the relevant assets when sold as a going concern

However, compounding the abovementioned lack of detailed regulation, sales of production units may raise some difficulties, namely they may:

- Lack transparency
- Result in a conflict with the interests of the entrepreneur or in an unfair competition vis-à-vis companies which are fulfilling their debt obligations

- Can be used on a fraudulent basis in order to avoid the payment of claims
- Be detrimental to certain creditors

The Conclusions set out the following rules for the relevant parties to consider in a sale of production units within an insolvency proceeding (whether within the liquidation phase or not):

1. Identification of the production unit and valuation: According to the Conclusions, the description of the production unit shall include the sales made by said production unit in the last three years and an exhaustive and detailed description of tangible and intangible assets. In respect of the valuation, the Conclusions set out that the discount of future cash flow shall be the valuation method.
2. Determination of the sale conditions:
 - 2.1 **The Conclusions set out the following parameters to value the offers (in hierarchical order)**:
 - (a) Price offered
 - (b) Collection of receivables (*i.e.* whether or not the debtor's receivables are transferred)
 - (c) Number of jobs preserved and their conditions
 - (d) Business plan providing reasonable comfort that the production unit will be viable
 - (e) Financial support to the company during the sale process
 - (f) Proper due diligence of the production unit
 - 2.2 **The Conclusions also set out other factors to consider**:
 - (a) There shall be a minimum price
 - (b) Possibility of improving the offer granted to the bidders of the three best offers
 - (c) The manner in which the sale proceeds are to be allocated shall be determined. If the production unit comprises assets subject to security, then the price allocated to the stated secured assets shall be expressly stated, as without this requirement granting the special privileged right over the secured assets to the secured creditors would be impossible.¹ This price allocation may take some time to be completed and therefore may delay the end of the process.
 - (d) The production unit is sold free of charge. Only the acquirer which becomes subrogated in the labor agreements will become subrogated in the pending obligations thereto, except for the amount satisfied by the Wages Guarantee Fund (*Fondo de Garantía Salarial (FOGASA)*). The Conclusions expressly state that the acquirer neither assumes tax claims nor social security debts. Notably, the stated write-off of social security debts may conflict with the general labor laws. Certain court rulings (from both Labor and Mercantile Courts) have expressly confirmed the opposite (*i.e.* that the acquirer becomes subrogated in those claims). Consequently, this specific Conclusion regarding the social security claims is controversial and poses some risk of (i) a potential review by the Superior Courts or (ii) an opposite understanding from Mercantile Courts outside Catalonia.

3. Publicity of the sale and its conditions: Apart from establishing certain rules regarding the publicity of the sale, the “entrepreneur’s”² right to be a bidder in the sale process is indirectly recognized. Undoubtedly, the most criticized sales of production units have been those in which the acquirers have been the former shareholder and/or directors of the insolvent debtor. As explained above, the Catalonian Mercantile Courts concluded that the advantages of the sales of production units outweigh these types of disadvantages.
4. Disclosure of the sale production data to all the interested parties: All the interested parties shall have the same opportunities. In this sense, the insolvency receivers shall store all the relevant documentation in a secure data server available to all the interested parties. However, the insolvency receivers may demand from the interested parties a deposit in order to access the stated secure data server (as set out in 6 below).
5. Implication of the employees’ representative: The employees’ representative shall effectively participate throughout the whole process. The potential acquirers and the employees’ representative shall have the opportunity to start negotiations in this stage.
6. Receipt of the offers conformed with the established objective rules: The bidders must make a deposit of not less than five percent of the approximate value of the production unit with a cap of EUR150,000. Likewise, all bidders must enter into a confidentiality agreement.
7. Potential breach and resolution of the sale: In case of a breach of the payment conditions or any other adjudication condition of the production unit, the insolvency receivers may regain the ownership of the production unit and terminate the sale agreement. In case the breach occurs before the adjudication, the defaulting bidder will lose the deposit and shall be liable for the damages caused not covered by the stated deposit. In our opinion the regulation of the pre-adjudication breach is reasonable and its application feasible. However, we have some concerns regarding the effective applicability of the post-adjudication breach remedies. On a different note, the Conclusions refer broadly to “breach” of the adjudication conditions. In our opinion, bearing in mind the potential consequences of a breach, the adjudication conditions should clearly distinguish between the most material breaches and the less relevant breaches; and only a material breach should result in the termination of the sale agreement.

Conclusion

Probably the Conclusions’ most relevant points include the understanding from the Catalonian Mercantile Courts that the (i) sale of a production unit is transferred free of charge — including tax and social security claims (save for certain labor claims), (ii) “entrepreneurs” are entitled to bid and (iii) insolvency receivers may regain ownership of the production unit and terminate the sale agreement in case of breach of the sale conditions.

Notwithstanding the foregoing, market participants should welcome the Conclusions as they shed light on a very important, though complex and controversial restructuring tool, which suffers from scant regulation. Certainly, the Conclusions represent one — though not the last — step in the right direction toward providing a detailed and transparent regulation for the sale of production units. Indeed, we still expect from the lawmakers a proper uniform and detailed regulation in the Spanish Insolvency Law applicable to the whole Spanish regime.

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Endnotes

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- ¹ In the event of liquidation, creditors holding a special privileged right are the first to collect payment against the assets on which they are secured — up to the secured amount.
 - ² Although the Conclusions refer to the general concept "entrepreneur," we understand that the stated term shall comprise both the shareholders and directors of the insolvent debtor.