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The sale of productive units in insolvency proceedings

March 31st, 2020



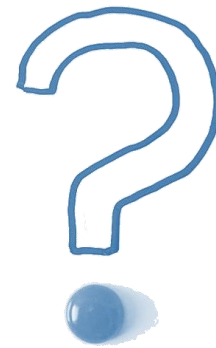
What credits is the acquirer subrogated from when acquiring a productive unit?

What steps must all investors follow before submitting an offer?

What happens to the suppliers' credits of the insolvent company?

What happens to credits regarding Social Security and labor?

The fast sale of productive units: *Pre-packaged insolvency* ("Pre-Pack")



What credits is the acquirer subrogated from when acquiring a productive unit?

The acquirer of a productive unit must meet the conditions of the sales and purchase agreement that is included in the **settlement plan** (that is elaborated by the insolvency administration and approved by the Judge of the arrangement of creditors) and in some cases, the acquirer can modify the purchase offer (mainly, in the cases of the direct sale of the productive unit).

As a general rule, **the transfer of a productive unit** in the liquidation phase of an insolvency proceeding **does not** involve the **transfer** of all the **liabilities** from the company declared insolvent, but the content of the settlement plan itself.

In order to facilitate these types of transfers, the legislator stipulates that the transfer is "*ope legis*":

- The transfer to the acquirer of the rights and contractual obligations (contracts affected);
- The transfer of administrative contracts (art. 214 LCSP);
- The transfer of licenses or administrative authorizations affected by the continuity, as long as the acquirer continues the activity in the same installations.

What steps must all investors follow before submitting an offer?

When bidding for a productive unit, legal and jurisprudential provisions must be taken into consideration to know the possible risks that are being assumed. Therefore, it is very **important to count with specialized advice before making a binding offer**, in the following steps:

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1. Previously develop an information search process (“*due diligence*”) that allows assessing the company and its risks, asking the insolvency administration to organize, in an agile way, a *data room* for the exchange of that information.
2. Verify and identify the productive unit and its valuation. What is going to be purchased and what is the combination of personal means (workers, management team) and materials (industrial warehouse, machinery, fixed assets, leasing property rights, inventory, raw material, etc.) or intangible (brands, designs, patents, copyright) necessary to develop a profitable productive activity. Particularly verify the strategic suppliers’ situation, the pending fiscal obligations, analyze the balances in order to fix the price at which the productive unit is going to be tendered at, etc.
3. Verify and **assess in depth the sales conditions that are normally included in the “Sales base of the productive unit” that are attached to the settlement plan**: (a) the Price offered and (b) payment terms, (c) the jobs in which the acquirer agrees to subrogate, (d) the working conditions offered to workers and, (e) the business plan.
4. Verify that the competitive sales process is transparent and safe, before accepting the binding offer (especially if penalty clauses exist in the “Sales base” in the event of the withdrawal of a binding and irrevocable offer, etc.).

The insolvency administration must take control of the proposal, value the offers and ultimately decide on the allocation of the assets. That is why it is **important to have advisors that negotiate so that the offer presented is successful**.

What happens to the suppliers’ credits of the insolvent company?

Transferring a productive unit in the liquidation phase **does not mean that all the recognized debt from suppliers is assumed by the acquirer**. Unless previously expressed in the settlement plan, the sale of the productive unit involves the **transfer of the assets of the debtor** (for example, the contract with suppliers included in the offer frame), **but not the transfer of the liabilities** of recognized suppliers in the insolvency proceedings.

Unless the operation is carried out by people especially linked with the debtor (partners, administrators, group companies, etc.), the transfer of the productive unit **will not imply that the acquirer has the obligation of paying non-satisfied supplier credits** by the company in insolvency before the transfer, **whether they are insolvency credits or claims against the estate**.

However, the acquirer will have the obligation of paying the obligations generated subsequent to the referred transfer (for example, future payments for provisions of services, possible monthly installments for rents, power supplies, merchandise supply, corresponding receipts for ordinary consumptions, etc.).

Suppliers, whose recognized quantities have remained unpaid in the insolvency proceedings, cannot modify the primitive contracts after they have expired (always depending on the negotiating force of the supplier). It is common that the “essential” suppliers previously thought of a way to compensate their losses when they had to refinance payments with the insolvent company.

What happens to credits regarding Social Security and labor?

Regarding debts with Social Security:

After the **Supreme Court rulings of June 17th, 2019 and the one from December 2nd, 2019, this matter is jurisprudentially settled in the article 149.2, of the Royal Decree-Law 11/2014**. Therefore, the acquirer of the productive unit is not released from payment obligations with Social Security.

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Regarding debts with workers' wages and compensations:

The assessment of business succession cannot be eluded by the way of the exclusion of the acquirer's responsibility, not even by the declaration done by the judge of the insolvency proceedings. The effects of the art. 44 ET are total in these assumptions, so **it is not possible to go further than that permitted by law and exonerate from responsibility the adjudicatory salary debts and compensations of the workers whose contract came to an end at the time of award as the worker was not subrogated.** The art. 149.4 LC establishes that when, as a consequence of the alienation, that is referred to in the first rule of the first section, an economic entity maintains its identity, understood as an organized grouping of resources to carry out an essential or accessory economic activity, **the professional and Social Security effects will be considered as a business succession.** In that case, **the judge may agree that the acquirer is not subrogated from pending wages or compensations previous to the alienation that is assumed by the FGS (Guaranteed salary fund), in accordance to the art. 33 ET** (Supreme Court Ruling. Social Hall of the 11th of September of 2019).

The fast sale of productive units: *Pre-packaged insolvency* ("Pre-Pack")

The legislator bets for the sale of the productive unit as a whole, as an organized group of goods and rights, of material and personal means that allow maintaining or resuming a productive unit, optimizing the value of the assets, improving the recovery of the creditors and keeping the workstations. **The purchase of the productive unit, is an interesting opportunity for competitors or investors, even for the workers,** of getting a hold of the company at an usually lower price than in any normal scenario, and at the same time "shield" its acquisition and "clean" it of the liabilities it carried before the insolvency proceedings.

This Pre-Pack is introduced in the reform of the abbreviated procedure of 2011, and seeks to avoid the intense impairment of the assets managed in the Court. Deadlines are shortened and the transfer is streamlined -inside the insolvency proceedings- of a productive unit to a third party with whom a pre-insolvency agreement has been reached ("*pre-pack agreement*").

The abbreviated procedure is extended to cases in which the insolvency application is accompanied by:

1. **Agreement proposal with a structural modification that transfers assets and liabilities unabridged** (art. 190.2 LC). Law of Structural Modifications 3/2009: merger, spin off or global assignment of assets and liabilities.
2. **Settlement plan with a binding offer of acquisition**, whether it is a functioning **productive unit**, or a case of **cessation of business activity** without existing employment contracts.



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- Regulation in the art. 190.3 and 191 ter LC.
 - i. The **application for the settlement process is submitted with a binding offer** and a settlement plan.
 - ii. The judge of the insolvency proceedings will agree with immediate effect the **opening of the liquidation phase**.
 - iii. It is transmitted to the **insolvency administration to report within 10 days**. The insolvency administration must include in its report the effect that the resolution will have on liabilities and asset claims.
 - iv. It is transmitted to the creditors for further allegations.
 - v. The judge **may agree in its order of approval of the offer, the resolution of the contracts pending compliance by both parties**.
 - vi. The inventory and list of creditors will be made (and it will be impugned) as foreseen in the art. 191 LC. Very shortened procedure.
 - vii. In the **case of the transfer of the productive units, the exceptions described in the articles 146 bis and 149 LC, will be considered**.
 - viii. The transfer of the productive unit is done, **through public deed or through a private contract** (only in the case of personal property), **without needing judicial authorization "ad hoc"**.

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