

DIRECTORS AND SUBORDINATED CREDITORS OF COMPANIES IN INSOLVENCY PROCEEDINGS

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In the prevailing economic environment it is useful to restate the position of “subordinated creditors” to those who hold the position of shareholders or board members of companies declared insolvent through the insolvency procedure.

Este artículo, preparado por Armando Betancor, de Araoz y Rueda, explica en términos generales la situación en la que se encuentran los acreedores subordinados cuando una empresa quiebra ante la imposibilidad de hacer frente a sus obligaciones financieras. Estos individuos no tienen el derecho a dar su voto para el acuerdo propuesto en la reunión de acreedores y su derecho a percibir una compensación es bastante limitado. El autor extiende esta situación a los derechos de un acreedor que tiene participaciones indirectas y al estado de un director de facto.

Subordinated credits (or subordinated debts) are those that will only be paid out once all other credits (privileged and ordinary) have been paid. Subordinated creditors are not allowed to vote on a creditors' agreement proposal and will only be able to collect their credits in the rare event that all

the other secured and unsecured creditors are repaid in full.

Moreover, the classification of certain credits as subordinated entails the extinction of any security granted in their favour.

Article 93.2.1 of the Spanish Insolvency Act declares the subordination of the claims of those shareholders of a publicly listed company in insolvency proceeding who hold 5% of the share capital, albeit with specific provisions applying with regard to the timing of the insolvency declaration. In the case of unlisted companies the same subordinated status applies to all those claims by shareholders who previously held up to 10% of the share capital.

After an analysis of said article, we consider that the law refers only to the percentage that the creditor holds directly in the society in insolvency proceedings, and that no involvement is held indirectly through other companies. Nor does it take into account any other mechanisms to control the capital of the companies, such as puts or calls agreements or syndicated agreements.

In addition, the de facto directors (referred to in Article 93.2.2 of the Spanish Insolvency Act) are also considered as subordinated creditors. Since there is no legal definition of the role of the de facto director we fall back on the almost unanimous interpretation by the most relevant authors, which is that the de facto director is one who exercises the effective control of the company although not being part of its board of directors.

Inclusion within this category may also extend to the legal representatives of the company who exercise the effective control, in most cases the parent company of the group. Credit that is rated as "subordinated credit" may determine that the de facto director may be condemned to indemnify any damages caused and – in the event that the insolvency proceedings ends in an insolvency Liquidation – pay the amount of the credits that remain unpaid after the liquidation of the company.

Nevertheless, clarification needs to be made between the credit position held by the parent which is subordinated, and the position of a de facto director and a declaration of guilt.

This question will be settled within the terms of the relevant section of the insolvency proceeding in the case of the liquidation of the company, which may lead to a creditors' agreement which provides for a waiver higher than one third of the amount of the debtor's liabilities, or a stay of more than three years.

In our opinion, and taking into account that most of the companies that have been placed in insolvency proceeding ended up in liquidation, we will see the guilt of the parent company (or shareholders of the companies declared in the insolvency proceeding) by their being taken to be a figure of the de facto director. In practice they will have the effective control of the company declared insolvent.

In order to avoid any such declarations we would recommend therefore the adoption of measures of real separation between the ordinary course of the society and the interests of the group of companies to which it belongs.

Armando Betancor is Head of Insolvency at Araoz & Rueda and can be reached at betancor@araozyrueda.com.