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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 proceeding. 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 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 taking 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 mother 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 mother 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 mother 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.

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