

NEW CRITERIA BEING APPLIED BY THE SPANISH SUPREME COURT WITH RESPECT TO INTEREST AND INSOLVENCY

The Spanish Supreme Court has recently rendered two judgments on the treatment during insolvency proceedings of interest accruing on secured claims which could give rise to serious practical consequences.

The first judgment refers to the acknowledgement in the insolvency proceedings of interest (in general) corresponding to secured claims. The judgment establishes that if the Insolvency Receivers have not included in the List of Creditors a contingent claim for interest that will accrue at a later date, the creditor will not be able to receive payment of any such interest.

The second judgment states that default interest does not accrue during the insolvency proceedings, even if such interest is secured, because once the insolvency situation has been declared it is impossible by law to make payments, which rules out the payment default scenario.

1. Supreme Court Judgment handed down on 20 February 2019 (Judge Rapporteur Mr Vela Torres)

a) Background

Pursuant to the list of creditors drawn up in the insolvency proceedings, a secured claim was acknowledged in favour of a financial creditor in an approximate amount of 375,000 euros, derived from two mortgage-secured loans.

After selling the mortgaged properties for a total of 513,000 euros, the Insolvency Receivers paid the creditor the principal amount, but refused to pay the default interest.

The creditor filed a separate court action claiming payment of the default interest. Although it is not clear, it seems that the creditor was claiming payment of interest accrued both before and after insolvency was declared.

b) Supreme Court Decision

The Supreme Court upheld the creditor's appeal and obliged the Insolvency Receivers to pay the amount acknowledged in favour of the creditor (approximately 375,000 euros).

However the Supreme Court warns that it is not possible to pay the creditor (any kind of) interest accrued after insolvency was declared, because a contingent claim (i.e., the liabilities which have not yet materialised) was not acknowledged in favour of the creditor in the List of Creditors, corresponding to interest to accrue at a later date. This occurred because the creditor failed to mention this interest, as a contingent claim in its claim form.

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In the majority of insolvency proceedings, secured creditors generally only file one claim and this was understood to include both interest that had already accrued as well as interest that would accrue in the future, up to the expiry date of the loan. As a result, the Insolvency Receivers only included in the List of Creditors one secured claim, without mentioning a contingent claim for interest.

As a result of this Supreme Court case, any creditor who has not had a contingent claim for interest acknowledged in its favour, would not be entitled to receive such interest, regardless of whether the interest is covered by the realisation value of the asset provided as security.

Based on such case law, if after selling a mortgaged asset, the Insolvency Receivers refuse to pay interest, the creditor will be obliged to bring an ancillary claim.

Even though the creditor could allege that its claim form and the List of Creditors had implicitly admitted the accrual of interest after insolvency was declared, a Judge can apply the Supreme Court doctrine, whereby the creditor would not be entitled to receive payment of (any kind of) interest accrued after insolvency was declared.

a) Binding nature

The criterion established in this judgment with respect to the acknowledgement of the claim for interest was reiterated in the judgment cited below, and therefore constitutes binding authority.

One other possible interpretation, however, is that the decision regarding interest may be considered "*obiter dicta*", to the extent that it did not determine the Court's decision (apparently the creditor only claimed payment of the amount acknowledged in the List of Creditors and this is the amount the Judgment awarded thereto).

In any case, in light of the judge rapporteur's authority and the fact that the terms of his decision were reiterated in the second judgment described below, one assumes that the Supreme Court -may follow this criterion in future cases.

2. Supreme Court Judgment handed down on 11 April 2019 (Judge Rapporteur Mr Sancho Gargallo)

a) Background

This is a similar case to the one described above, in which the financial creditor had a mortgage over a property.

According to the creditor's claim form, the List of Creditors included a secured claim in an approximate amount of 117,000 euros, which included remunerative and default interest accrued before insolvency was declared. After such insolvency declaration, default interest accrued in an approximate amount of 40,000 euros.

The asset was sold at auction for 140,000 euros, but the Insolvency Receivers refused to pay the creditor the amount obtained from the sale. The creditor filed an ancillary claim for payment.

b) Supreme Court Decision

The Supreme Court ratified the criterion of the above-mentioned judgment: it confirmed that the creditors with mortgage should include in their claim form, not only the amounts due at that time, but also a contingent claim, to cover the interest to be accrued at a later date. If creditors fail to do this, they will not be entitled to claim interest later on.

The Judgment adds a new aspect in its decision in relation to default interest. It found that default interest cannot accrue after the insolvency declaration, because during insolvency proceedings the debtor does not pay because it cannot do so, not because it does not want to. It also found that, during the insolvency proceedings contractual mechanisms like interest and default payments, which incentivise prompt payment of financial obligations, make no sense whatsoever. Accordingly it concludes that default interest does not continue to accrue after insolvency is declared.

c) Binding nature

As far as we know the criterion established in this judgment regarding default interest has not been reiterated in subsequent cases, and therefore for the time being it does not, strictly speaking, constitute binding authority. However, in light of the judge rapporteur's authority, one assumes that the Supreme Court may follow this criterion in future cases.

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