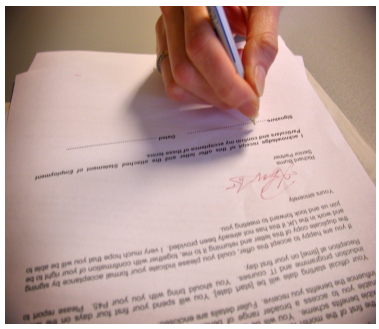
Spanish Corporate - Real Estate Legal Update

# Review

Nº 14 – January 2011



## In this issue:



## The risks of the reverse mortgage and the credit crunch

Following the enactment of Law no. 41/2007, of 7 December, the development of the Reverse Mortgage *("Hipoteca Inversa")* has been affected by the current situation in the real estate sector in Spain and by the international credit crunch.

The Reverse Mortgage is a product created in order to promote economic growth and reactivate the real estate sector by getting the cash value of the regular dwelling by paying rent to a protected collective group, such as people over 65 years of age, or those affected by a severe or major dependence. However, unfortunately these goals are not being attained, due to the current situation of the real estate market, the continuous depreciation of the value of the residential market and the increased life expectancy. All of these factors make it difficult and limit the granting of loans guaranteed with mortgages of these characteristics.

In addition to the aforementioned difficulties, we should also refer to the customary clause generally included in this type of financing, by which the banks cannot request the repayment of the loan granted, until either the property that is mortgaged as the guarantee is sold, or until the owner or the last of the beneficiaries of the loan dies. This customary clause merely makes it more difficult to grant this kind of financing for the banks which are facing a great level of uncertainty when it comes time to being able to establish the estimated date on which they will be able to recover the amount which they have paid out.

Furthermore, it is also a customary practice to establish a period following the death of the debtor, in which the heirs of the mortgaged property can decide whether to make the payment of the debt assumed by the deceased debtor, either by means of the sale of the afore-mentioned property, or as an alternative, in the event that they agree not to sell the property, they can proceed to pay up the amount due by the deceased debtor to the financial entity. This could also entail a novation of the period of repayment and of the terms and conditions of the financing granted to the deceased debtor.

Regardless of the foregoing, we should also say that even if the period of time agreed upon for the repayment of the loan is established in the deed, the banks can encounter other additional problems related to the inheritance, such as the validity or non validity of the Last Will which could be denounced by one of the heirs. This would result in a delay in the creditor's pretensions to collect the debt until this controversy is decided and settled.

In addition, there are other risks related to the mortgage market, such as those related to the specific value of the appraisal of a property on the date the mortgage was granted and its possible depreciation when the debt expires. This circumstance could even lead to a situation in which the value of the deceased debtor's assets are not enough to cover the total amount owed to the bank, with the additional disadvantage that in this case, the creditor entity could only proceed against the debtor's patrimony. The entity could not proceed, not even in a subsidiary manner, against the patrimony of the heirs.

Together with the foregoing, we should also highlight the fact that in most of the cases, the interest on these loans is calculated based on a fixed interest rate and not on a variable one, which together with the uncertainty and random nature for determining the expiration date of these loans, would make it difficult for the banks to grant loans of these characteristics, because they cannot determine the possible variable increase in the interest rates during the term of the contract.

All of the foregoing, together with the international credit crunch, impedes the achievement of the effects and goals sought by the Reverse Mortgage.

*Sandra Paoletti*

# Extension of the exceptional system applicable in cases of legal cause for dissolution as a result of losses

As a result of the international financial situation in recent years and its repercussions on the Spanish financial market and, in particular, the restriction of the financing offered to small and medium-sized companies, the Spanish Government has been approving a series of exceptional measures in order to improve and facilitate said financing.

Consequently, last 13 December 2008, as part of the anticrisis measures adopted by the Government, the Royal Decree - Law no. 10/2008, of 12 December, came into force, adopting diverse financial measures for the improvement of the liquidity of the small and medium-sized companies, and other complementary financial measures.

Among these measures an exceptional system stands out (with a limited temporary validity) for the mandatory reductions of share capital and the winding up of Joint-Stock Companies and Limited Liability Companies a result of their losses.

In accordance with A*rticle 327 of the Share Capital Companies Act*, the share capital reduction of a Joint-Stock Company will have a mandatory nature when the losses incurred have reduced its net equity to less than two thirds of their total share capital and a fiscal year has elapsed without the net equity being recuperated.

Additionally, in accordance with *Article 363 of the Share Capital Companies Act,* both the Joint-Stock Companies as well as the Limited Liability Companies will be dissolved as a result of losses which reduce their net equity to less than half of their share capital, unless such share capital is then increased or decreased to a sufficient extent, and as long as bankruptcy proceedings does not need to be requested.

In accordance with the foregoing, the losses due to deterioration, which are significant in certain companies, as they are included in the Profit and Loss Account will have to be taken into account to the effects of determining the loss of net equity under the indicated events of share capital reductions and winding up of companies. However, the evolution of the international economic activity in recent years situates us within an extraordinary context which give place, in accordance with the afore-mentioned Royal Decree - Law no. 10/2008, to the application of an exceptional system, which consists of not taking into account the losses due to deterioration recognized in the annual accounts derived from the Tangible Fixed Assets, the Real Estate Investments and the Stock for the purposes of determining the losses for the mandatory reduction of the share capital and for the winding up of the companies foreseen in the foregoing articles.

Regardless of the foregoing and, as we have already mentioned above, the aforementioned exceptional system had a temporary validity consisting of the two fiscal years ending as of 13 December 2008.

When the 2009 fiscal year came to an end and given that the evolution of the international economic activity still finds us within an exceptional context, it continues to be necessary to maintain the suspension of the afore-mentioned corporate system, applicable only for the cases of losses due to the deterioration of the Tangible Fixed Assets, the Real Estate Investments and the Stock and for the purposes also mentioned above.

It is for this reason that last 1 April 2010, Royal Decree - Law no. 5/2010, of 31 March, came into force, extending the validity of the afore-mentioned exceptional system for the mandatory reductions of share capital and the winding ups of Joint-Stock Companies and Limited Liability Companies, as a result of the indicated losses, for an additional term of the two new fiscal years to be closed as of this new Royal Decree – Law enters into force. The foregoing refers to the fiscal years 2010 and 2011, unless, during said years, the corporate fiscal year of the company is modified and with it, it is created a corporate fiscal year of less than one year, in which case, the benefits of this exceptional system will be temporarily limited to the two fiscal years instead of the two years.

*Eva Sánchez*

# The latest innovations in matters of Urban Leasings

Last 23 December 2010, Law no. 39/2010, of 22 December, on the General State Budgets for 2011, was published in the Official State Bulletin, and this Law has introduced certain innovations on Urban Leasing matters.

The first innovation introduced and effective as of 1 January 2011 with an indefinite validity, is the modification of Section 6 of Article 36 of Law no. 29/1994, of 24 November, on Urban Leasings, although the rest of the article maintains its original wording. In this sense, we should remember that said Article 36 regulates the obligatory requirement of providing a deposit upon the signing of the

leasing agreement. In particular, establishes a cash deposit equivalent to one monthly payment of the rent in the leasing of a dwelling and two monthly payments in the leasing of premises to be used for purposes other than that of a dwelling.

The modification of Section 6 of the afore-cited Article 36 is intended to expand the Public Bodies that are exonerated from the obligation of furnishing a deposit. In particular, the exception of furnishing a deposit now extends to the following: "The General State Administration, the Administrations of the Autonomous Communities and the entities making up the Local Administrations, the autonomous bodies, the public entrepreneurial entities and the rest of the public entities linked or dependent upon them and the 'Mutuas' or Private Societies covering Occupational Hazards and Professional Diseases of the Social Security System, in their public duties involving collaboration in the management of the Social Security system, as well as their Joint Centres and Entities, when the rent has to be paid at the expense of their respective budgets".

In addition, the second modification in terms of Urban Leasings is included within the framework of the reorganization of the activity of the State's Lotteries, Betting and Pools introduced by the afore-cited law on General State Budgets, which has established the following:

"All of the patrimonial sales, corporate operations and others acts derived either directly or indirectly from the application of the present additional provision which has the public entrepreneurial entity 'Loterías y Apuestas del Estado' or the 'Sociedad Estatal Loterías y Apuestas del Estado' as the obligor, will be subject to the application of the system of tax exemptions and tariff reductions foreseen in Sections 4 and 5 of Article 168 of the Law no. 33/2003, of 3 November, on the Patrimony of the Public Administrations.

In case of leased properties and for the purposes foreseen in Article 32 of the Law no. 29/1994, of 24 November, on Urban Leasings, regarding the transfers which might be carried out, cessions of leasing contracts in force will not be considered, nor will the lessors have the right to any kind of increase in rent related to them".

*Alfonso López*

# Resolutions of the Directorate General of Registries and Notaries Public and recent case law

**SUPREME COURT, FIRST SECTION (CIVIL), DECISION 1090/2007, OF 7 JULY 2010**

The Sentence that we will analyze below refers to the right of first refusal requested by the lessee of a property, based on the justification of applying the price corresponding to the "real value" paid at the time by the buyer, or, to the contrary, it should apply the corresponding "market value" of the afore-cited property.

The Judge of the Court of the First Instance granted the pretensions of the lessee of the property when this latter party was aware that the mentioned property, which was leased by the defendant, had been sold by the previous owner. This breaches, then, what is established in article 48.2 of the Urban Lease Act of 1964 (at present, Article 25 of the current Urban Lease Act), and grants as well the right of first refusal action for the same price that the defendant had paid at that time.

Afterwards, in the Second Instance, the Provincial Court of Barcelona partially granted the appeal, establishing that the price, which the lessee had to pay in order to exercise the right of first refusal, had to coincide with the "current price" or "the market value" of the property, plus the legitimate expenses. In this sense, even though the Provincial Court established that "in principle the price which has to be taken into account in the subrogation which the right of first refusal involves is the price

which appears in the leasing contract, in doubtful cases or when there is no record of said price, it is necessary to adhere to the real price, which is what must prevail and what must be reimbursed". In the case in question, it so happens that in addition to the fact that the price was paid by the present owner more than 20 years ago, it is a much lower amount and it did not corresponds to the location and characteristics of the property, being the property sold to a close relative of the previous owner.

In the light of the afore-mentioned Sentence under appeal, the Supreme Court issued a decision regarding the matter of whether the price of the right of first refusal is that which the parties have freely agreed upon or, to the contrary, it should be the result of the real value of the property at the time of the granting the right of first refusal action. The Higher Court revoked the Sentence in an appeal establishing that the real price does not mean real value or current price, and so the option holder should pay the price actually paid by the buyer, once it is proven what the amount was finally paid.

The fact that a great deal of time has transpired between the buying and selling transaction and the exercising of the right of first refusal action, does not justify the decision to set as a price for the right of first refusal a higher amount than that which was actually paid in the mentioned transaction, since the consequences of the lack of communication to the lessee of the circumstances of the buying and selling transaction must fall upon the parties participating thereof and not on the option holder.

And finally, the Supreme Court established that the price of the right of first refusal must be the real price effectively paid by the buyer, in such a way that this party is found in a situation of financial indemnity after the right of first refusal, even though the price which appears in the buying and selling transaction is different to what was actually proven.

*Ignacio Domínguez*

**RULING OF THE DIRECTORATE GENERAL OF REGISTRIES AND NOTARIES PUBLIC (LAND), OF 1 OCTOBER 2010**

In this Ruling, the Directorate General examines the appeal filed by a Notary Public of Estepona in the light of the refusal of the Land Registrar to record a mortgage deed as a guarantee for a loan on a current account in its modality as a Reverse Mortgage or Equity Release. He alleged that certain financial and early repayment clauses are contrary to the principles of our legal system, even when the mortgage deed clearly indicated the main amount of the debt and any corresponding interest agreed upon, or the maximum amount of the mortgage liability, identifying the obligations guaranteed and their duration.

The present ruling is of undeniable interest as it determines that the registrational control over financial and early repayment clauses will be limited only to those which may contravene the legislation in force. Said control cannot be extended to those other aspects which as they are undetermined juridical concepts, may only be declared abusive by virtue of a specific judicial resolution.

Furthermore, this new pronouncement states that the afore-mentioned financial and early repayment clauses, to which the reformed Article 12 of the Mortgage Law refers, must be recorded in the Land Registry, under the condition that the Registrar deems favourable those clauses which have property right significance and configure the property right of the mortgage.

Further to the foregoing, the present ruling also confirms what the Supreme Court has stated on other occasions in relation with the clauses which prohibit the mortgage debtor from carrying out actions such as selling, mortgaging, encumbering or leasing the property and the subsequent early repayment in these cases. It established that said clauses must be considered as abusive and thus cannot be recorded, as it would be limiting the dispositive power of the mortgagor, something that is not allowed in our legal codes, except when it is a matter of business without valuable consideration,

and even in those cases, it is limited in time. Together with the foregoing, the Directorate General distinguishes the precedents of the obligations of not ordering what does not have a property right significance and only a merely binding content, admitting that in certain circumstances, they may be accepted, although it would be merely for binding purposes between the parties.

In addition to the foregoing, the Directorate General establishes that it is out of proportion to attribute a resolutory nature to any breach, as this is only possible when it is a matter of a breach in an obligation of special relevance and, under no circumstances, if it is a matter of accessory obligations or irrelevant breaches.

As a matter of conclusion, we should say that the registrational reflection of early repayment clauses and other financial clauses should necessarily be carried out under the same terms as the corresponding mortgage deed, unless its nullity has been declared by means of a judicial decision or was considered objectively contrary to a legal regulation. However, under no circumstances can the registrational activity undertake to evaluate the circumstances under which the supposition of a specific event has been carried out.

*Ignacio Domínguez*

**SUPREME COURT, FIRST SECTION (CIVIL). DECISION 535/2010, OF 30 JULY 2010**

In the present article we analyze the possible unapproved assignment of the position of the lessee of a business premises on behalf of another lessee, who is subrogated in the foregoing, failing to comply in this way with what is established in Article 114.5 of the Urban Lease Act of 1964 (at present, Article 27.2.c of the current Urban Lease Act).

The legal action filed by the lessor of the commercial premises, in which the resolution of the leasing contract is requested as a result of an unapproved assignment of the lessees' position, is established on the basis that due to the death of one of the three joint lessees, the other two lessees have automatically assumed the position of the deceased lessee.

In view of the foregoing, the defendant lessees argued that when they adopted the substitution of the position of their father, the initial lessee of the premises, they sent the lessor a notification informing him not of a tacit but an express pact of joint and severally liability between the lessees "as they were and have been a subjective unit. This should have been understood, when the three appeared at the same time, effecting the same manifestations, from which a common, unitary, indivisible interest can be inferred and clearly one which was joint and severally".

The Judge of the First Instance rejected the legal action arguing that the joint and severally liability nature of the joint entity between the lessees is presupposed and that the part which corresponded to the deceased lessee proceeds to form a part of the exploitation of the other lessees. The desire of the interested parties to create a generating obligation from a joint and severally relation is thereby presupposed.

Afterwards, in a Second Instance, the Provincial Court of Seville rejected the appeal filed by the lessor party, as it considered that the jurisprudence of the Supreme Court should be applied, which allows the existence of joint and severally obligations that are not expressly declared, but from which such a nature can be deduced, as it is determined by the juridical community of common goals and interests between the prestations of the different debtors, as it occurs in the present case. In addition, the ruling of the appeal established that the presence of the three lessees was not necessary in order to understand the leasing agreement as subsistent, as is the case when the lessees are husband and wife and one of them dies. In this case, the fact that the other spouse continues with the leasing is not questioned.

In view of the Provincial Court's Sentence to reject the legal action, the lessor filed a Cassation Appeal based on the provisions of Articles 1.137 and 1.138 of the Civil Code, that is, that the joint nature is the general rule, while the joint and severally nature is the special rule and must be specifically agreed between the parties.

In the light of the foregoing, the Supreme Court established that even though for these suppositions the oldest jurisprudence requires a joint and severally express agreement , this position has been modified by more recent jurisprudence which establishes that even though the joint and severally nature is not presupposed, as is stated in Article 1137 of the Civil Code, "nor does it prevent the tacit joint and severally nature from being applied, when among the obligated parties, there is a juridical community of goals and purposes and thus a connection between everyone involved is evidenced".

The Supreme Court thus ratified the Sentence of the Court of the First Instance and the one of the Provincial Court, granting total validity to the leasing agreement and confirming the afore-cited tacit joint and severally nature between the lessees as a result of the juridical community or connection of common goals and purposes of said lessees.

*Ignacio Domínguez*

---

## FOR MORE INFORMATION

Please contact:

**Ramón Castilla**

Partner

T: +34.91.426.4840

F: +34.91.435.9815

E: ramon.castilla@ssd.com

(*) Squire Sanders Hammonds awarded as **REAL ESTATE LAW FIRM OF THE YEAR 2010** in Spain by the following International Publications: (i) Corporate Intl Magazine, (ii) Finance Monthly Magazine, (iii) InterContinental Finance Magazine and (iv) Global Law Experts.