



## Subcontractors' direct action and bankruptcy in Spain

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The impact of the financial crisis experienced in Spain in the last few years on property sales and construction levels is no secret. In the aftermath of the crisis, even some of the strongest construction companies have faced insolvency, with their fall creating shockwaves throughout the rest of the sector. The purpose of this article is to examine how a construction company's insolvency may affect other players within a construction project with whom agreements were already in place. As we shall see, there are serious implications for subcontractors, who may lose some of their normal rights and privileges under the Spanish Civil Code in such circumstances.

When a property owner or real estate developer is interested in the construction of a building project, often it hires a general contractor that will be responsible for the overall coordination of the project and will provide the material and services necessary for the construction of the project. The contractual framework of major projects can be complex and the main contractor hires expert subcontractors to perform specific sections of the construction work. No contractual relationship exists between the property owner and the subcontractor. Rather, the contractual relationship is between the main contractor and the subcontractor.

However, when the main contractor breaches the subcontractor's construction agreement and does not pay the agreed fees, article 1597 of the Spanish Civil Code grants the subcontractor a direct action against the property owner in order to recover the unpaid amounts, up to a maximum amount that is not greater than that owed by the owner of the works to the main contractor. This legal remedy is an exception to the general principle of privity of contracts ("principio de relatividad de los contratos") which provides that a contract cannot confer rights or impose obligations arising under it on any person or agent except the parties to it. The exception is based on equitable reasons: namely, the need to avoid an unjust enrichment and to widen the scope of financial responsibility for a third party's debts.

In line with case law from the Supreme Court, this direct action requires the following requirements to be met before a subcontractor can make a claim:

- The price of execution of the works shall be certain and determined (or determinable) in the works agreement
- At the moment the claim is filed, those who work and provide their material and services for the works shall be creditors of the main contractor and the debt shall be due and payable

Even when these requirements are met, if the main contractor is affected by an insolvency proceeding, the scenario will change substantially, because then the direct action may not be used. Recent precedents from the Supreme Court have determined that the subcontractor is not entitled to bring a direct action against the owner of the works in the event that the main contractor was declared insolvent. This is because the privilege attached to a direct action is inconsistent with other principles of insolvency proceedings under Spanish law. In particular, it is inconsistent with the *par conditio creditorum* principle, that means that all creditors must, in principle, stand the same chance to collect their debts. The aim of this principle would be frustrated if the income received by the insolvent contractor from the property owner went

directly to the subcontractors instead of being paid to the creditors in the order of precedence in which they are established in the insolvency proceedings.

The trend defended by the Supreme Court's case law and the *par condition creditorum* principle forced the Spanish legislator to amend the Spanish Insolvency Act in 2011, in order to include an express statutory provision on the action provided in article 1597 of the Spanish Civil Code. The prohibition is now regulated by article 53.3 of the Spanish Insolvency Act, which expressly states that subcontractors may not bring a direct action against the property owner during insolvency proceedings concerning the main contractor. Instead they will need to file their claim in the insolvency proceedings and stand in line with the rest of the creditors.

In conclusion, article 1597 entitles subcontractors to claim from the property owner amounts owed by the main contractor. But, given that this privilege is inconsistent with the terms of the Spanish Insolvency Act (the core aim of which is to preserve the principle of equality of creditors), the Spanish Insolvency Act denies subcontractors this right in insolvency situations, as direct action is considered to be contrary to this principle.