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REFORM OF SPANISH INSOLVENCY LAW

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Legal Briefings – By **Nicolás Martín, Javier de Carvajal, Armando García-Mendoza and Jaime de San Román**

The Spanish government has very recently approved a reform of the Spanish Insolvency Law, which will enter into effect within 20 days of its publication in the Spanish Official State Journal (Boletín Oficial del Estado), except for the third book of the restated Spanish Insolvency Law, which will enter into effect on 1 January 2023.

The reform, as well as establishing a more agile insolvency process, brings about significant changes to insolvency regulations, particularly when related to pre-insolvency. Although not the only amendments introduced by the reform, we highlight below those changes that we understand are of greatest interest due to their impact, such as (1) the increased scope and importance given to pre-insolvency; (2) the new tools that encourage and make it easier for companies facing financial difficulty to resort to restructuring, passing greater power over to the creditors; and (3) introducing a new specific set of rules governing the sale of productive units.

The reform of the Spanish Insolvency Law will increase the number of company restructurings. By giving creditors greater power it will be easier to pursue debt negotiation processes and this will, we believe, encourage and even force the acquisition of companies in financial difficulty. In particular, funds – the holders of the debt – will find it easier to acquire equity interests in impaired companies as shareholders will find it harder to avoid their stakes becoming diluted. The reform will certainly bring about a new way of performing M&A.

NEW PRE-INSOLVENCY REGULATIONS

The reform **broadens the scope for applying restructuring mechanisms**, establishing a system where it is possible to resort to this mechanism earlier (without having to await current or imminent insolvency) and extending restructuring to more types of creditors (not only financial creditors).

A **new category of insolvency – "foreseeable insolvency"** – is established. This makes it possible to apply for pre-insolvency and request the approval of restructuring plans at an earlier stage. Foreseeable insolvency is understood to exist when it is objectively foreseeable that the debtor will be unable to meet its payment obligations falling due in the following two years if a restructuring plan is not agreed.

The content of pre-insolvency notices is also broadened. Although the debtor does not have an obligation to provide evidence of its financial position or its proximity to insolvency, a pre-insolvency petition must now include a list of the creditors with which negotiations are underway (previously, an abstract statement sufficed) as well as the amount of their claims; the total amount of all claims and the date on debts to the public authorities fall due (previously there was no obligation to include a list of creditors); the amount of the debtor's assets and liabilities; its turnover and number of workers; and a list of the assets and rights and contracts that are considered necessary for the debtor to continue business.

The **length of the pre-insolvency process** remains at three (3) months (plus an additional month to file for insolvency if the financial impairment persists), which may be extended by a further three (3) months at the request of the debtor or creditors holding more than 50% of the insolvency claims.

Pre-insolvency **continues to afford considerable protection against enforcement and petitions for compulsory insolvency** and continues to suspend the legal obligation to file an insolvency petition.

As for the impact of pre-insolvency on contracts, it makes it **possible to suspend the right to terminate contracts** containing outstanding reciprocal obligations if those contracts are necessary for the debtor to continue to do business (this does not affect contractual netting arrangements as per RDL 5/2005).

Finally, the new system makes it **possible to block the enforcement of third party guarantees over claims held against the pre-insolvent debtor** if the guarantor is a member of its same group and the pre-insolvent debtor proves that enforcement could trigger the insolvency of the guarantor or its own insolvency.

RESTRUCTURING PLANS

Restructuring plans are now **the only available pre-insolvency restructuring mechanism**, replacing the two options provided up to now by the Spanish Insolvency Law – refinancing agreements (*acuerdos de refinanciación*) and schemes of arrangement (*acuerdos de homologación*).

This does not mean that parties cannot use other restructuring mechanisms, but the new instrument is essential to benefit from the protections (eg, against set-aside actions) or benefits (eg, possibility of dragging along dissenting creditors; privileged treatment given to new money claims) afforded by the Insolvency Law, a court-approved restructuring plan is the only available option. **The process for sanctioning a restructuring plan** will therefore involve a creditors' vote followed by court approval in certain situations.

In terms of the extent to which a debtor's financial position may be reshaped by a restructuring plan, **those plans have a very broad scope** – the purpose may encompass modifying the debtor's assets, liabilities and equity structure; and include transfers of assets, productive units, or the sale of the entire business, together with any necessary operational changes.

The reform also ventures beyond the existing regulation in terms of the types of claims that a restructuring plan may encompass. **The restructuring plan may now affect any claim**, except for certain spousal maintenance debts, debts arising out of tort or employment relationships (excluding top executive relationships). Although debts to the public authorities may also be affected, in practice the law only allows minor changes (limited to rescheduling not exceeding 12 months from the court's decision approving the restructuring plan and a maximum of 18 months from the date on which the pre-insolvency petition was filed for approval of the plan).

The reform also establishes that the **claims encompassed by a restructuring plan must be grouped into classes** – among other things, the classes are then used as a basis for calculating creditor votes. While the reform does not include a rigid set of rules for forming the different classes, it establishes as a general principle that creditors within the same class must share an objectively justified common interest.

The reform also sets out several **criteria to provide guidance on how classes may be defined** (eg, how claims would be treated in an insolvency scenario; whether or not the debt is financial; the impact of the restructuring plan on the claims).

Debts to the public authorities constitute a single separate class. The same happens with secured claims unless the disparity between the assets or rights securing the claims justifies that they be separated into two or more classes.

It is possible to impose the restructuring both on dissident creditors within a class that voted in favour of the plan as well as on entire dissident classes. The reform establishes the following system of majorities for creditors to approve a restructuring plan:

- The plan will be considered as having been **approved** by a class if creditors holding more than 2/3 of the overall debt held by the class votes in favour of the plan (3/4 if the class is composed by secured claims). The same majorities will apply to syndicated debts

unless a lower threshold is established in the syndication agreement.

- If the plan is not approved by every class, **cramdown** (by drag-along) of dissenting classes is possible provided that the plan is partially approved on the following terms:
    - by a simple majority of classes, provided that at least one of the approving classes is composed of claims that would have constituted privileged claims in an insolvency scenario; or
    - by at least one class of claims that – according to the debt classification contained in the Insolvency Law – is presumed will receive some level of repayment if the debtor is assessed as being a functioning business. In that scenario, court approval of the plan will require the appointment of a restructuring expert who will produce a valuation report.
- Secured creditors cannot be the subject of inter-class cramdown in respect of the portion of their debt that is secured.

A restructuring plan approved by the creditors containing **measures affecting the company's shareholders** (eg, debt-for-equity conversions) may be imposed on the latter even if the general shareholders' meeting voted against the plan. The ability to drag along the shareholders only exists where the debtor is in a position of imminent or current insolvency when the plan is approved.

Approved plans may also be extended to group companies guaranteeing or providing collateral to secure the debts restructured by the plan provided that enforcement of the guarantee/security could trigger the guarantor's and the debtor's insolvency.

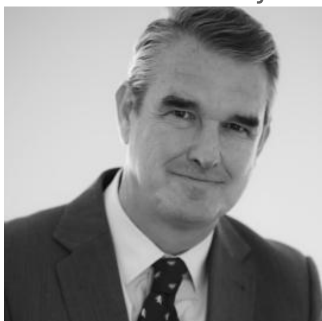
The Insolvency Law affords **privileged treatment** to claims derived from interim financing and new money in the event of subsequent insolvency. Thus, provided that interim financing or new money is granted as part of a restructuring plan approved by at least 51% of the debtor's total debts, 50% of those debts will constitute claims against the insolvency estate, while the remaining 50% will be claims enjoying general privileges.

Dissenting creditors or shareholders affected by the restructuring plan may **challenge the court's approval based on a limited list of grounds**, including (i) failure to reach the majorities needed to approve the plan; (ii) failure to meet formal requirements during the approval process; (iii) absence of foreseeable insolvency, current insolvency, or imminent insolvency; (iv) uncertainty as to the ability of the restructuring plan to prevent the debtor's insolvency and to ensure the debtor's viability in the short and medium term; (v) asymmetrical treatment given in the plan to similar classes of debts; or (vi) the plan resulting in creditors facing a worse outcome – in terms of the treatment given to their claims – compared to the debtor's liquidation.

PROCEDURE FOR THE SALE OF PRODUCTIVE UNITS

The reform also introduces a procedure for the sale of the debtor's productive units. It allows bids to be submitted along with the insolvency petition. That will then trigger a process in which competing bids may be submitted. The productive unit will be awarded by the judge on the basis of evaluation information prepared by the insolvency administrators – the award will go to bid that is most beneficial in the interests of the insolvency.

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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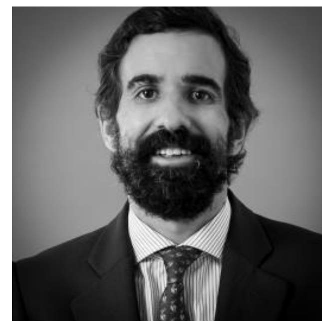

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