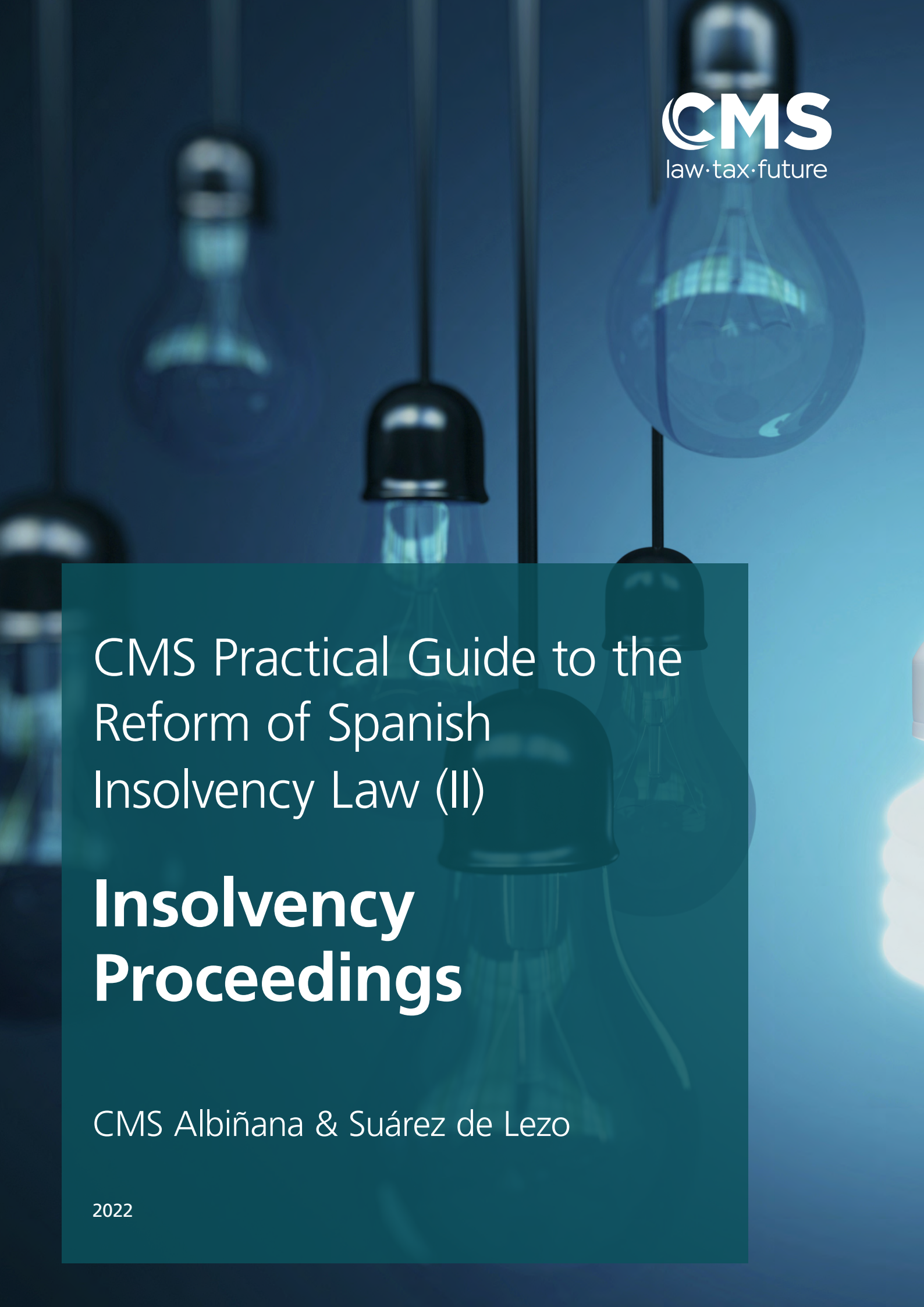

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CMS Practical Guide to the Reform of Spanish Insolvency Law (II)

# Insolvency Proceedings

CMS Albiñana & Suárez de Lezo

2022

# CMS Guide to the Reform on the Spanish Insolvency Law

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With the publication of law 16/2022 on the 6th of September 2022, Spain put an end to a thorough review of insolvency law, hereby transposing European Directive (EU) 2019/1023 (dated 20th June 2019) on preventive restructuring frameworks, on discharge of debt and disqualifications, and on improved procedures for restructuring, insolvency and discharging debt.

The task was, undoubtedly, not an easy one. It faced no fewer than 607 amendments as a Draft Bill on its journey through Congress, and more than 250 in the Senate.

Of the numerous updates (published in 170 pages of the Official State Gazette) affecting all the regulations in force up to now, we would like to begin by highlighting the new pre-insolvency regulations, particularly restructuring plans as one of the key aspects of the reform.

Secondly, the new legislation introduces numerous procedural innovations in the insolvency proceedings. These amendments are intended to make insolvency proceedings more effective and efficient, although the implications of some of these could also be relevant in terms of the liability of directors, and therefore merit special consideration.

From this new reform package, we would like to highlight the changes affecting the agreement (*convenio*), the removal of liquidation plans as we know them, new regulations concerning immediately payable debts and expenses, insolvency proceedings without or with insufficient assets, as well as those affecting the qualification phase, the role and legal status of the insolvency administrators, and the waiver of unsatisfied liabilities. What's more, in a bid to offer greater legal certainty to those involved in insolvency proceedings, the reform has introduced a simpler appeals system as well as the removal of the so-called 'deferred appeal', which has also been quite problematic to apply.

In line with the principles governing the reform, a new Third Book has been added which focuses on special insolvency proceedings for micro-enterprises, characterized and governed by the principle of maximum procedural simplification.

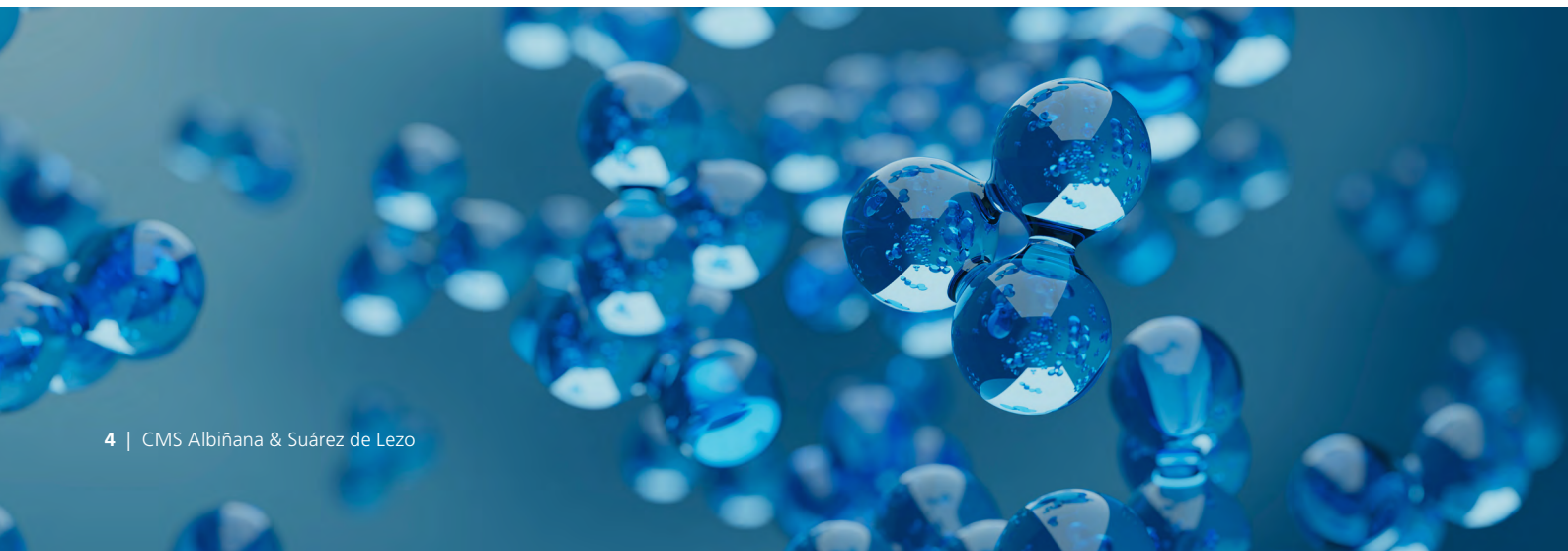
Thirdly, the regulation of the sale of production units should also be highlighted, both at an early stage, giving this the status of insolvency "pre-pack", and furthermore as an integral part of the restructuring plans, such as during the processing of the insolvency proceedings, which in the past

was widely applied and allowed preservative solutions to be found to many situations.
Finally, it is also important to highlight exactly when the reform comes into effect.
On the one hand, the new regulations on the special insolvency procedure for micro-enterprises is relegated to enter into force on 1 January 2023, with the exception of the rules on appointing an insolvency administrator, which is subject to further legislative development that should have been approved in April 2015 yet is still pending. Consequently, micro-enterprises that can no longer count on the protection of the insolvency moratorium will also be unable to make use of the special system in place within the new regulations for the next 4 months.
The rest of the reform came into force twenty days after its publication, i.e., it became valid on 26th September 2022, notwithstanding the fact that some regulations, such as those affecting the insolvency administration, statistics or the public Register still have to be developed, which means that the full application of this reform will necessarily be staggered.

To ease understanding and provide a practical scope of this reform, in the following pages we have tried our best to offer the reader the key facts on this important reform divided into three sections:
— The first one is on pre-insolvency and innovative restructuring plans.
— The second concerns insolvency proceedings.
— And the third deals with the sale of production units.

# New guidelines for insolvency situations

| | | |
|---|---|---|
| Insolvency | Current | Debtor unable to meet payment obligations on a regular basis. |
| | Imminent | Debtor foresees an inability to meet payment obligations in a regular and timely manner for the following three months. |
| | Likelihood of insolvency | When it is objectively foreseeable that, if a restructuring plan is not reached, the debtor will not be able to regularly meet payment obligations due within the next two years. |



# Changes in the specific rescission rights for insolvency

| Before the reform | New rescission time frame |
|---|---|
| Up to two years before insolvency was declared | Up to two years before insolvency as requested. |
| | Any time between insolvency being requested and declared. |
| | Up to two years before negotiating with or intending to negotiate with creditors is communicated so as to reach a restructuring plan. |
| | From the moment when communication of negotiations is made until the declaration of insolvency, provided that a restructuring plan has not been approved or, even if approved, has not been endorsed, and that the insolvency proceeding is declared within the year after the validity of such communication or extension has expired |

Reminder: Fraudulent intent is not a requirement in an insolvency rescission action.

| New developments in this area |
|---|
| Those acts that acknowledge debts or facilitate debt repayment that help bring the situation in line or lessen the insolvency liability as outlined in criminal law cannot be rescinded. |

# Latest developments concerning immediately payable debts and insolvency proceeding expenses

**Immediately payable**

- Debts arising from tort or death or prior or subsequent personal injury or compensation for work-related accidents or illness that are dated before the insolvency proceeding is declared.
- Debts for foodstuffs that arose and were due prior to the declaration of insolvency.
- Debts related to advertising the insolvency declaration, or from precautionary measures and other resolutions.
- Debts arising from paying the insolvency administrator and the restructuring practitioner for gathering purchase offers for the production unit.
- Debts for interests or earnings if there is a delay in handing over goods and rights over third party property.
- Credits granted to the insolvent debtor prior to the opening of the settlement phase to finance the compliance with the judicially approved agreement, according to the viability plan, if so provided for in the agreement. Likewise, credits granted by specially related persons as per the requirements set in the insolvency act (*persona especialmente relacionada con el concursado*) if the debtor and the maximum amount of financing to be allowed has been identified in the creditor's agreement.
- 50% of the amount of the debts derived from interim financing or new financing granted under an approved restructuring plan (if the debts affected by such plan represent at least 51% of the total liabilities or, when finance has been granted by persons specially related to the debtor as per the requirements set in the insolvency act - *persona especialmente relacionada con el concursado* - more than 60%) with deduction of such debts so as to calculate said majority.

# New developments with respect to the classification ofinsolvency debts

**Insolvency credits**

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| **Special privilege credits** | Restructuring plans are subject to the limit of the fair value of the asset or right on which the guarantee has been constituted, with the appropriate deductions. |
| **Special privilege credits** | Credits for payments related to crimes against the Treasury regulated in Title VI of the General Tax Law. |
| | 50% of the amount of the debts derived from interim financing or new financing granted under an approved restructuring plan (if the debts affected by such plan represent at least 51% of the total liabilities or, when finance has been granted by persons specially related to the debtor as per the requirements set in the insolvency act more than 60%) with deduction of such debts so as to calculate said majority. |
| **Ordinary credits** | Insurer's credit for subrogation, return or reimbursement in case of insured damages. |
| **Subordinated claims** | Nothing new added here. |
| **Other claims** | Those contracted by the debtor during the period of compliance with the agreement, in the event of non-compliance with the agreement and the ex officio opening of the settlement period due to a declaration of nullity of the approved agreement. |
| | Claims for damages from the counterparty to a debtor's contract if such contract is terminated in the interest of the insolvency proceedings. |

# Updates to the creditor's agreement phase as introduced by this reform

## From the point of view of the insolvent party

| | |
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| **Filing** | **Proposal of a creditor's agreement together with the request for the declaration of insolvency, or at any time thereafter**, provided that 15 days have not elapsed since the filing of the insolvency administrator's report. |
| **Admission for processing** | If the insolvent party submits the proposed creditor's agreement together with the request for the declaration of insolvency, **the judge will decide upon its admission in the same order declaring the insolvency proceedings**. |
| **Settlement** | If neither the insolvent party nor the eligible creditors submit proposals, or if none are admitted, the judge will decide **ex officio**, by means of an order, to open the **settlement phase**. |
| **Resources** | An **appeal for reversal** may be filed against the decision to admit the proposed creditor's agreement.<br>Once the appeal for reversal has been resolved, **no further appeal is available**. It will no longer be possible to bring the issue up again in the next appeal (with this reform removing the so-called 'deferred appeal'). |
| **Acceptance** | The insolvent party may **accept the proposed creditor's agreement(s)** submitted by the creditors during the allocated time period, without this implying the revocation of their own proposal.<br>The judge cannot approve a creditor's proposal without it being accepted by the insolvent party. |
| **Priority to the insolvent party's proposal** | The **insolvent party's proposal will be considered first**. If it is not accepted, the creditor's agreement(s) that have been accepted by the insolvent party will be looked at. |
| **Opposition** | **New grounds for opposition**: that the insolvent party has not accepted the proposal presented by the creditors. |

# Updates to the creditor's agreement phase as introduced by this reform

## From the point of view of the insolvent party

### Capital increase by way of the creditor's agreement

If the court accepts the creditor's agreement to convert insolvency debts into shares:

- The shareholder's agreement to a capital increase disappears
- The partners' preemptive rights are abolished
- New shares can be transmitted over a period of ten years from the registration of the capital increase in the Mercantile Registry.

### Merger, spin-off or complete assignment of assets and liabilities through the creditor's agreement.

- The registration of such transaction would close the insolvency proceeding.

### Modification of agreement

- Once the agreement has been in place for two years, proposals to change it can be presented if there is a risk of non-compliance for reasons not attributable to fraud, fault or negligence and it is demonstrated that this change is essential for the viability of the company.
- While this amendment to the agreement is being processed, applications for breach of the agreement and for settlement to begin will not be admitted for processing.
- Once the agreement has been modified, subsequent changes are not possible.

### Breach of agreement

- Any prejudicial acts against the assets of the insolvency estate that the insolvent party may have carried out prior to the claim stating that there has been a breach of the agreement can be rescinded or, if unsuccessful, upon requesting the opening of the settlement phase.
- Once the declaration of a breach of agreement is legal binding, any acts carried out throughout the duration of the creditor's agreement that have contravened it or altered the equal treatment of creditors who are in equal circumstances shall be null and void.

# Updates to the creditor's agreement phase as introduced by this reform

## From the creditor's point of view

**Filing**

Creditors representing at least 1/5 of the liabilities are entitled to submit creditor's agreement proposals.

**Deadline**: from the declaration of insolvency proceedings until 15 days from the filing of the Insolvency Administrator's report

**Processing in writing**

This leads to the **dissolution** of the creditors' committee and processing in writing.

**Adherence**

An adhesion **in writing** is addressed to the Insolvency Administrator accrediting the identity and representative powers of the signatory.

If several creditor's agreement proposals are suggested, the creditor may adhere to one, several or all of them, expressing the order in which such adhesion is to be computed.

There is a two-month deadline for creditors to adhere to the creditor's agreement. The time limit starts when the admission process begins but if the deadline is reached without a provisional list of creditors being sent to the insolvency administrator, it can be extended by fifteen days from when that provisional list has been presented.

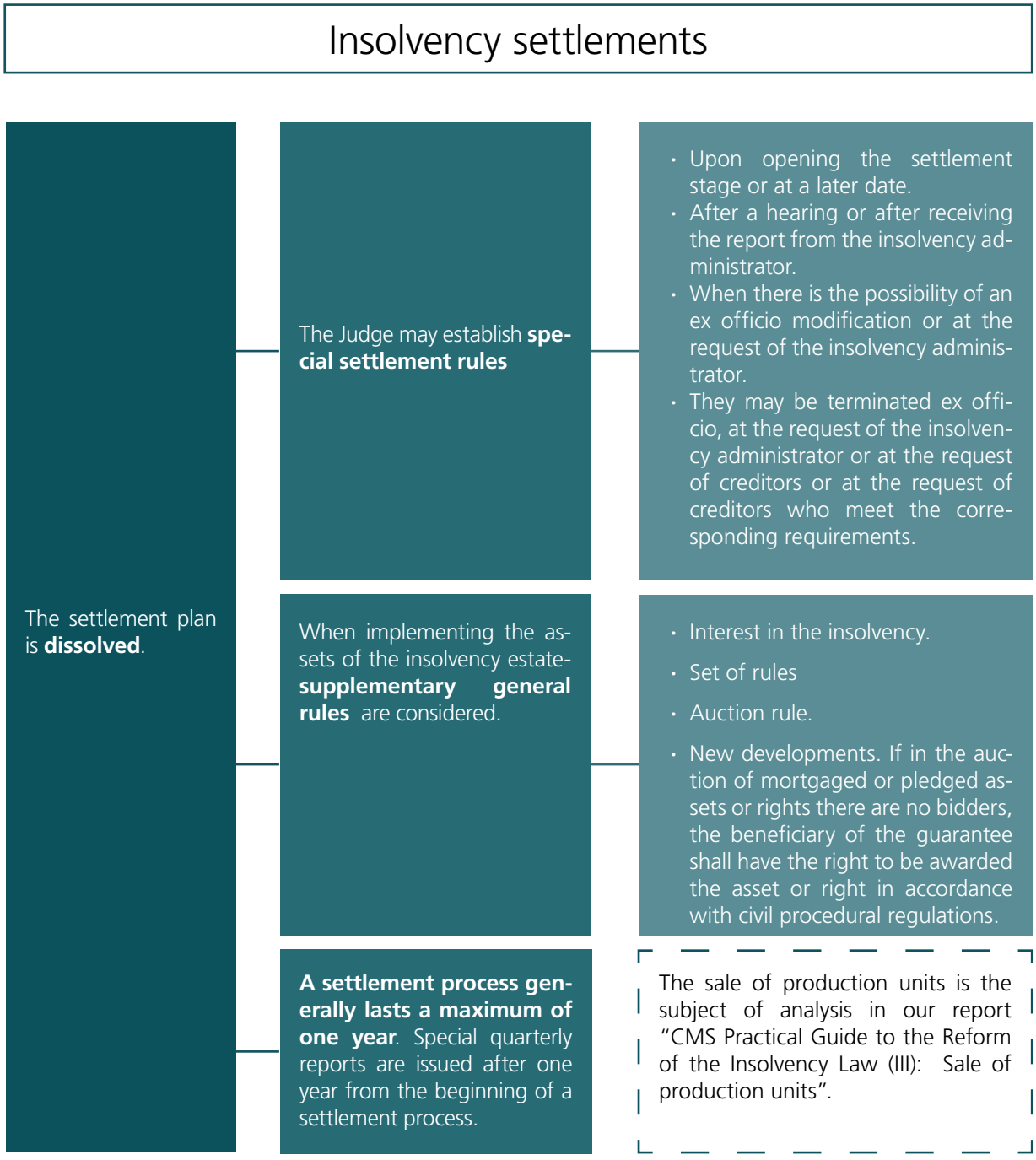
**Opposition**

New grounds for opposition:

- Mistakes in the acts of adhesion of the creditors
- The insolvent party's rejection of the creditor's agreement
- That the opposing party could obtain a bigger settlement of the credit owed than if the creditor's agreement is carried out.

Creditors cannot oppose in the event of a proposed merger, spin-off or complete assignment of assets and liabilities

# New developments in the settlement phase*




* Notwithstanding the special procedure for micro-enterprises

# Updates to the criteria for class formation

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|---|---|
| Formation of credit classes | • Ratings will be established before the court order ending the common stage of the insolvency proceeding<br>• Any classification exemption that may have existed by way of a creditor's agreement has been abolished, with credit classes now becoming obligatory. |
| Classification proposals | • During the allotted time period for notifying credits, documents and facts can be sent to the insolvency administrator by email so as to provide basis for the negligent bankruptcy (*concurso culpable*).<br>• The date for issuing the insolvency administrator's report has been brought forward. New deadline: 15 days following the filing of the provisional inventory and list of creditors.<br>• New credit class rating report: if allegations have been made in support of a negligent bankruptcy classification (*califación culpable*) and such represent 5% stockholding or hold credits of over one million euros. This includes termination proposals along the same lines as the insolvency administrator's report. |
| Processing of reports | • The insolvent party is informed and a summons is sent to all affected parties and/ or accomplices if any of the reports request a negligent bankruptcy classification (*calificación culpable*).<br>• Simultaneous notification of a hearing to be held within the following two months. It may be waived if there is ultimately only an evidentiary hearing (*prueba documental*).<br>• If there is evidence of a crime that cannot be prosecuted solely at the request of the aggrieved party then the Public Prosecutor's Office will be informed.<br>• If the insolvency administration requests the classification of the insolvency proceeding as fortuitous and there is no credit class rating report, the proceedings will be filed by means of an order which will not be subject to appeal. |

| | |
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| Classification after breach of creditor's agreement | • Certain acts considered to be a negligent breach (*incumplimiento culpable*): Fraudulent outflow of goods or rights from the debtor's assets and acts aimed at simulating a fictitious asset situation.<br>• Presumption iuris tantum of a negligent breach. Failure to push on payment obligations, failure to request settlement and other accounting failures in the space of three fiscal years prior to the breach of the creditor's agreement.<br>• From a subjective point of view: The affected parties have been legal representatives, administrators or liquidators (de facto or de jure) or general managers within the period of the creditor's agreement. |
| Possible transaction concerning the economic content of the classification | • Before it has been transferred to the parties in the assessment stage<br>• Upon approval of the insolvency judge. If denied, no appeal can be heard against the Court order in question.<br>• An appeal can be lodged against the Court order approving the transaction by the parties who have argued against it. |
| Classification ruling | • It requires the notification of the disqualification to the Land Registry and the Mercantile Registry, as well as to the Single Computerized Index of Article 242 bis of the Mortgage Law.<br>• Special rules regarding costs:<br>— Any judgement that rejects to classify a bankrutpcy as negligent (*calificación culpable*) despite the request of the insolvency administrator for such classification, will not rule that costs be paid by the insolvency administrator except for in recklessness<br>— Any judgement that classifies the bankruptcy as negligent will not rule that persons included in the classification or defined as accomplices pay any costs that should be paid by those eligible parties who had argued against the negligent classification. |
| The non-binding scope of the rating classification | • This is non-binding for judges in the criminal courts as well as those working on judicial reviews. |

# Other changes regarding the updated responsibility of company directors:

## Changes to articles 365 and 367 of the Corporate Enterprises Act (hereinafter, LSC)

**Duty of the directors to call a general meeting**
**Article 365.3**

- The directors will not be obliged to call a general meeting to adopt a dissolution agreement when:
  - ·The insolvency application has been duly filed; or
  - The court has been informed that negotiations with a view to reaching a restructuring plan are taking place.
    - Once this notice expires, a general meeting must be called immediately.

**Joint and several liability of directors for obligations once the event causing winding-up had taken place or, if named after this event, obligations upon accepting the position of director**
**Article 367.3 LSC**

- An exception to this joint and several liability is introduced if, within two months of having accepted the position / the winding-up order, the directors had:
  - Duly filed the insolvency application; or
  - Informed the court that negotiations with a view to reaching a restructuring plan are taking place.
    - If the restructuring plan is not agreed upon, the period of two months that was put on pause when restructuring negotiations were announced will start to run again.

**Contradiction concerning the counting of the two-month time.**

# New special procedure for microenterprises

## Subjective requirements

- Natural or legal person that carries out a business or professional activity.
- The number of employees during the previous year must have averaged at less than ten employees, when the total number of hours worked by the whole team equals or is less than would have been given to at least ten employees working on full time hours
- Annual turnover of less than 700,000 euros or liabilities of less than 350,000 euros in the last accounts of the previous tax year.

## Target budget

- Probability of insolvency, imminent insolvency or current insolvency.

## Alternative pathways

- Continuity of the business activity
- Settlement proceedings*, with or without transfering the business as a going concern.

*Necessarily applicable if at least 85% of the credits correspond to public authority creditors.

## Who can apply for this?

- The debtor themselves - In the case of a legal entity, its administrative body.
- Creditors or partners personally liable for the debts of the currently insolvent debtor.

## How to apply?

- Application is made through a lawyer.

- Standardized form - Electronic filing and processing except when there is a lack of means.
  - Via digital judicial headquarters
  - Via Notaries
  - Via Commercial Registry Offices
  - Via those Chambers of Commerce that assume this function.

The Third Book, dedicated to the special procedure for microenterprises will enter into force on January 1, 2023, with the exception of Article 689.2. (supplementary rule for the appointment and remuneration of the insolvency administrator).

# New developments in the exoneration of liabilities dissatisfied

**Possibility of requesting exoneration of unsatisfied liability:**

- Subject to a payment plan without prior liquidation of the assets.
- With liquidation of assets - If the insolvency proceedings conclude with closing the settlement phase or due to insufficient funds to cover the debts.

**Expansion of the list of those who are prohibited from being exonerated due to the debtor's profile meeting certain conditions.**

**Deadlines for submitting a new application:**

- After exoneration through payment plan → At least 2 years from the final exoneration.
- After exoneration with liquidation of the assets → At least 5 years from the resolution granting the exoneration.

**Changes in the scope of the exemption:**

- Excluded, in addition to debts for maintenance and debts that are governed by public law (as a general rule), debts for the following items:
  - Non-contractual civil liability, for death or personal injury, or for indemnities derived from work-related accidents and occupational ill-health.
  - Civil liability derived from crime.
  - Wages for the last 60 days of work carried out prior to the insolvency declaration in an amount not exceeding three times the minimum interprofessional wage and wages accrued during the proceeding whose payment has not been undertaken by FOGASA.
  - Fines in criminal proceedings and for very serious administrative sanctions.
  - Costs and legal expenses for the processing of the exoneration request.
  - Secured debts considered as having special privileges.
- Possible partial and limited exemption from:
  - Debts that are due to AEAT
  - Debts that are due to Social Security.

  Requirement: it must be the first exonoration of the debtor's unsatisfied liabilities - Not applicable to successive exonorations to be obtained by the same debtor.

# The new regulation of insolvency without estate

Any creditor of the estate may request at any time that the insolvency administrator make a decision as to whether there is an insufficient estate or whether it is foreseeable that the estate will be insufficient to meet the payment of such credits. If no response is received, or if only a generic or imprecise reply is given, the judge can be approached for help contacting the insolvency administrator once more, with the possibility of reducing the retribution or separating the duties.

## Presuppositions:

1. The insolvent party has no attachable assets or rights.
2. The market value of the assets is disproportionately less than the cost of freeing them.
3. The market value of the assets is less than the cost of the procedure.
4. The amount of existing charges and encumbrances is higher than the market value.

## Unique features of this type of insolvency procedure:

Request to be considered insolvent

If any of the insolvency without estate conditions are met, the judge will issue an order declaring the insolvency proceeding with an indication of the liabilities and will order its publication, with a call to creditors (at least 5% of the liabilities) so that within 15 days they may request the appointment of an insolvency administrator to issue a report. If the debtor were an **employer**, the insolvency declaration will be notified to the legal representation of the employees.

If no report is requested, a debtor who is a natural person (rather than an entity) may request exoneration of the unsatisfied liability.

If a report is requested from an insolvency administrator, one will be appointed by the judge by means of a court order that will set a time limit of one month from accepting the position to issuing the report.

# The new regulation of insolvency without estate

## Contents of the report of the insolvency administrator appointed at the request of the eligible creditors

Proof - or lack of evidence - showing that the debtor had carried out voidable acts that were prejudicial to the asset estate.

If there is sufficient evidence for a corporate action of liability against the directors or liquidators of the company or against the natural person appointed as manager by the company with the most responsibility in lieu of duties being delegated to one or more managing directors.

If there are sufficient indications that it will be classified as a negligent bankruptcy.

# Developments in international private law

## Employment contracts subject to Spanish law:

- In the event of a main insolvency proceeding opened abroad but with impact in Spain, all employment contracts and employment relations under Spanish law will be governed by the TRLC.
- When, in accordance with the TRLC, the insolvency judge has jurisdiction over employment matters, the commercial judge who would have dealt with the insolvency for territorial matters will have authority to approve the termination or modification of employment contracts and employment relations, even if no insolvency proceeding has been initiated in Spain.

## In Pre-insolvency Law*:

- **The TRLC's application of the rules of Private International Law**:
  - Pre-insolvency communications of the TRLC.
  - Foreign preventive restructuring procedures functionally equivalent to those of the TRLC.
  - Effects of the communication of the opening of negotiations/approval of restructuring plans, except for the special rules of articles 723 to 731, applying only that of article 726 of the TRLC.
- Groups of companies with subsidiaries abroad: The Spanish courts with jurisdiction to hear pre-insolvency proceedings on the parent company of a group of companies, may extend such jurisdiction to subsidiary companies whose main interests may be outside of Spain provided that:

  → The parent company has requested such move or will be subject to a restructuring plan.

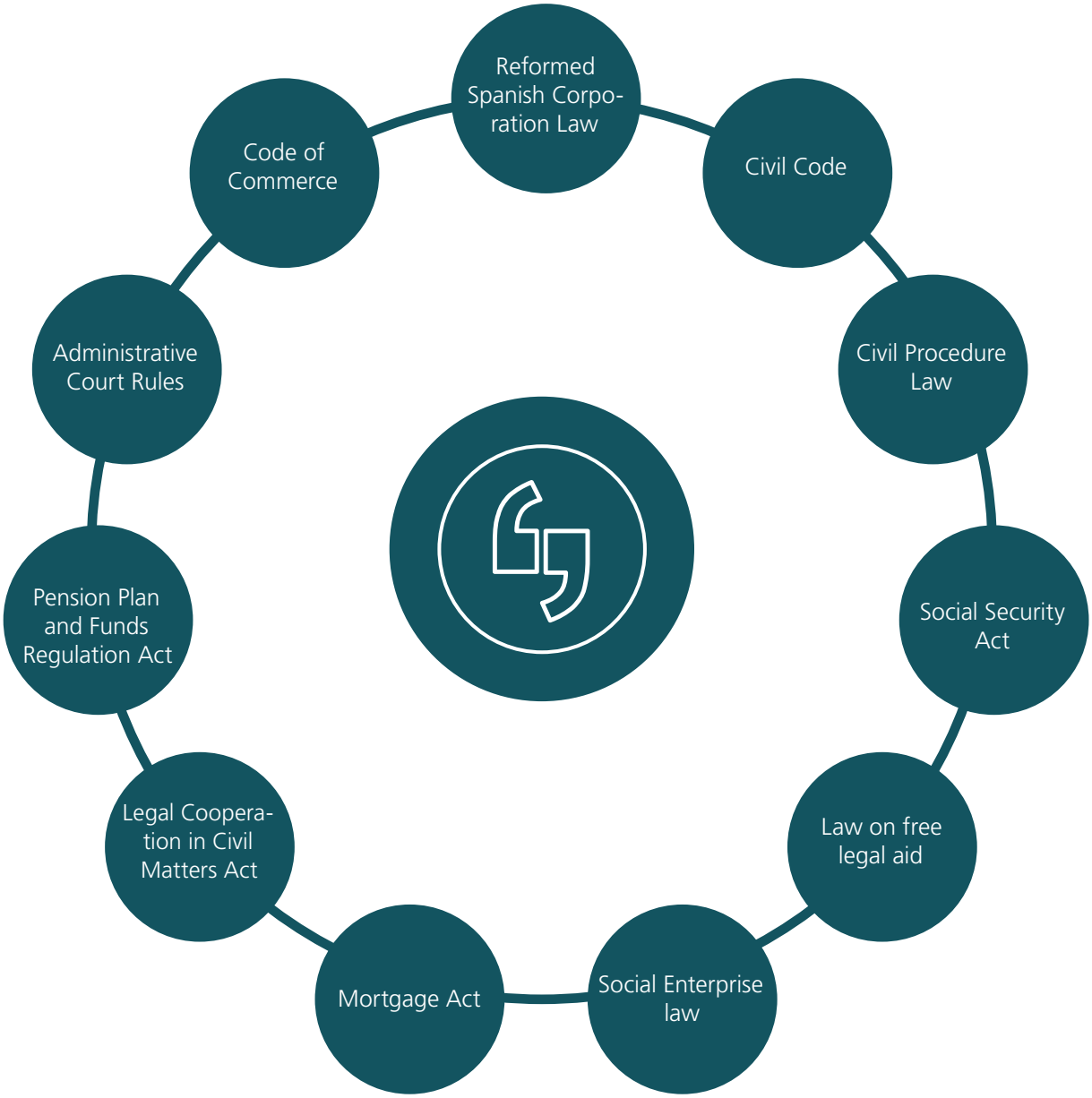
  → The communication or approval has been requested as reserved with respect to the subsidiaries.

  → That, in order to ensure the successful completion of the negotiations of a restructuring plan or of its compliance, it may be necessary to extend jurisdiction over the subsidiaries

  **!** This jurisdiction shall only extend to the creditors with contracts in common between the parent company and its subsidiaries.

* The novelties of the reform regarding Pre-insolvency Law and Restructuring Plans are analyzed in our publication: CMS Practical Guide to the Reform of the Insolvency Law (I): Pre-insolvency law.

# Other regulatory changes included



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