GARRIGUES updates

restructuring and insolvency work

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1. REFORM OF THE SPANISH INSOLVENCY LAW BY LAW 14/2013, TO SUPPORT ENTREPRENEURS AND THEIR INTERNATIONALIZATION

On September 28 the Official State Gazette published Law 14/2013 to support entrepreneurs and their internationalization (the "Entrepreneurs Law"). This new law has been enacted to bring in reforms that will encourage growth and business activity, and it has amended numerous elements of the Spanish Insolvency Law, especially in relation preinsolvency matters and in three key components:

- Amendment to the Formal Refinancing Agreements legislated in additional provision four (better known as the "Spanish scheme"). A more flexible rule has been included on the computation of the majority of liabilities that sign up to the scheme, for the purpose of extending the deferral stipulated by the majority to the nonparticipating or dissident entities.

- More complete rules on the procedure for appointing an independent expert responsible for issuing the report on the debtor's viability and the proportionality of the guarantees.

- Allowing schemes outside the insolvency proceeding between certain types of debtors and their creditors, under a scheme called an "out of court payments agreement" overseen by a person in the new role of insolvency mediator.

In addition, the so-called "fresh start" has made its first appearance in Spanish law whereby a debtor who is an individual can, within an insolvency proceeding, cancel once and for all any debts that could not be satisfied with their property and assets that are present. The scope of this fresh start is restricted, however, because it will only be available to certain types of debtors; it does not apply for public law claims and requires the debtor to satisfy certain classes of claims in full (preferred claims especially, which include those secured by a mortgage or pledge).

The main changes made by the Entrepreneurs Law are summarized below.

1.1 New percentage for authorization of Formal Refinancing Agreements

The reform has considerably brought down the percentage of financial liabilities that must be achieved to extend a deferral stipulated in a Formal Refinancing Agreement to nonparticipating or dissenting financing parties.

From the entry into force of this new reform (which in relation to this element takes place on September 29, 2013) the new percentage of financial liabilities that will be required to extend the deferral in a Formal Refinancing Agreement to dissenting entities will only be **55%**, twenty percentage points below the former 75%, introduced in 2011, which was in force in 2012 and on the basis of which some of the more significant claim refinancing deals were completed (the latest issue of our newsletter described several of these cases and explained some of the most recent decisions, which envisaged the option to extend the deferral in a Formal Refinancing Agreement to include secured creditors also).

1.2 Independent expert appointment procedure

The reform has added a new article 71 bis to the Insolvency Law, with detailed provisions on the appointment procedure for the independent expert to give an opinion on the Formal Refinancing Agreement and, specifically, on the viability of the debtor or of the group refinancing the debt, and on the proportionality of the guarantees.

Many of the elements that have been added serve to resolve doubts over the procedure for appointing this expert and issuing the report, which to date had to be answered by the Commercial Registrars responsible for appointing them.

The elements that have now been clarified and standardized include:

- **How to file the request**

  The request for appointment of the independent expert must be accompanied by both the debtor's identification particulars and the documents relating to the Formal Refinancing Agreement, if one has been reached, together with a list of the creditors and the group companies affected, if any.

- **When to file the request**

  It is expressly allowed for the request for appointment of the independent expert to be filed even before there is a final version of the Formal Refinancing Agreement. In this case, the request must be accompanied by the draft agreement and the viability plan, or at least a term sheet.

- **Conflicts of interest for the independent expert**

  The independent expert will be subject to the same rules as those set for auditors in the relevant legislation. None of the following can be appointed as independent experts: (a) the debtor's auditor, (b) the auditor of the affected group companies, (c) or the person who prepared the viability plan attached to the Agreement or to the draft Agreement.

- **Term for issuing issue the report**

  The independent expert must issue his report on the Formal Refinancing Agreement within the time period specified by the applicant and, in all cases, within one (1) month from acceptance of his appointment, although this time period can be

extended one or more times with just cause. If the report is not issued in that time period the request will be deemed to have expired and a new appointment will be started.

1.3 New out of court payments agreement: the insolvency mediator

The new reform has added a new Title X to the Insolvency law, dealing with the out of court payments agreement, a mechanism designed to secure out of court negotiation of a Payments Plan with creditors as an alternative to the insolvency proceeding and to the Formal Refinancing Agreement.

- **Who can negotiate an out of court payments agreement**

  Only the following parties can negotiate an agreement: (i) an entrepreneur (an individual) in a position of current or imminent technical insolvency with liabilities below €5 million; and (ii) a legal entity in a position of technical insolvency with fewer than 50 creditors and assets or liabilities below €5 million, provided that in both cases the costs of the agreement can be met and the projected assets and revenues will be sufficient to allow a viable agreement.

  Agreements of this type cannot be negotiated by: (i) anyone who in the previous three years has reached an out of court agreement, has had a refinancing agreement authorized or has been the subject of an insolvency order; (ii) anyone who negotiates a Formal Refinancing Agreement or has filed a petition for an insolvency order and their petition has been admitted for consideration; and (iii) anyone who has a creditor in an insolvency proceeding who is going to be affected by the agreement..

- **Which claims are affected**

  Public law claims or secured claims cannot be affected by the agreement, without the express consent of their holders.

  Once the out of court agreement has been admitted, the debtor must request the postponement of any public law claims with amounts outstanding. The decision on split or deferred payment of those claims will be rendered when the out of court payments agreement is perfected and the deferral stipulated in this agreement will act as a limit for that decision, although different payment intervals can be determined.

- **The role of insolvency mediator**

  The agreement must be negotiated and concluded by a person called an "insolvency mediator", who will be appointed by the Commercial Registrar for the debtor's address if the debtor is an entrepreneur or an entity subject to registration. Otherwise the mediator will be appointed by a notary.

  The mediator can be an individual or a legal entity and must be registered on the new Register of Mediators and Mediation Institutions of the Ministry of Justice and, besides meeting the conditions laid down in Law 5/2012, of July 6, 2012 on

mediation in civil and commercial matters, must be a lawyer, economist or auditor having at least five years' actual experience in the practice of their profession. Their fees will be established according to the tariff approved for insolvency managers.

- **What are the effects of commencement of the procedure?**

  No insolvency order can be issued whilst the debtor is negotiating the out of court payments agreement.

  After the procedure has started, the debtor will be able to continue to operate, but without being able to apply for loans or credit facilities on electronic media.

  Following publication of the commencement of the procedure, the creditors will not be able to start enforcement proceedings against the debtor's assets for a period of three (3) months, except for secured creditors; if a secured creditor does start or continue with an enforcement proceeding, then that creditor will not be able to participate in the out of court agreement. A creditor with a personal guarantee can enforce the guarantee if the claim it holds against the main debtor is due.

  Once the commencement of the procedure has been noted on a public register, no subsequent attachments can be noted, unless they are exercised by public law creditors or secured creditors that are not participating in the agreement.

- **What does a Payments Plan consist of?**

  Following acceptance of its role as such, the insolvency mediator will identify the existence and amount of the claims and call the debtor and creditors (other than public law creditors) to a meeting to draw up a Payments Plan.

  As soon as the insolvency mediator is able, and in all cases twenty days before the meeting, that mediator will send a Payments Plan to the creditors which must contain a release not higher than 25% and a deferral for not longer than three years. The Payments Plan will be accompanied by a viability plan, a proposal for the performance of any new obligations that may be incurred and a plan for the company. The Payments Plan may include assets given in payment.

  If after the Payments Plan has been sent, a number of creditors accounting for a majority of the total liabilities decided not to continue with the negotiations, the insolvency mediator would be required to petition for an insolvency order.

  The mediator will also have to petition for an insolvency order if the Payments Plan is rejected at the meeting, or if it is approved and later not fulfilled by the debtor.

- **Majorities and effects of the Payments Plan on the creditors**

  The majority needed to approve the Payments Plan is 60% of the total liabilities, or 75% if it includes assets given in payment (in this latter case it must have the approval of the creditors with security interests in the assets given in payment). Only the creditors affected by the Payments Plan will be computed to determine the quorum.

If the Payments Plan (and therefore the out of court agreement) is approved, none of the creditors affected by it can start or continue with enforcement proceedings for debts incurred before publication of the commencement of the procedure.

The creditors have an obligation to attend the meeting called by the insolvency mediator, unless they have already submitted their decision for or against the Payments Plan. Those who did not attend and did not express their decision for or against will have their claims subordinated in any potential future insolvency proceeding, unless they hold secured claims.

- **Perfection and public disclosure**

  The out of court agreement must be recorded in a public deed and, if required, it will be registered at the Commercial Registry. It must also be notified to the court responsible for issuing the order for a potential insolvency proceeding on the debtor, besides having to be published in the Official State Gazette and entered on the Insolvency Public Register.

- **Failure to achieve an out of court agreement: the "consecutive insolvency proceeding" and the restricted fresh start**

  The consecutive insolvency proceeding takes place following a petition for an insolvency order by the debtor or by the creditors where they can prove that they were unable to reach an out of court payments agreement or if such an agreement has not been fulfilled or has been cancelled. In an insolvency proceeding of that type, the liquidation phase will commence simultaneously (unless there are insufficient assets in which case the specific rules on insolvency proceedings without assets available to creditors will be applied).

  In the insolvency proceeding, the insolvency mediator will be appointed as the insolvency manager, and will not be entitled to higher remuneration than the amount received for their previous mediation role for the out of court agreement, unless the judge finds there are exceptional circumstances.

  The two year period to determine transactions for clawback (against which clawback actions can be taken if they cause harm to the assets available to creditors) will be computed from the application date for the start of the out of court procedure to the commercial registrar or notary.

  If the debtor in the consecutive insolvency proceeding is an individual and the proceeding is judged to be non-culpable, the judge will decide on the remission (or cancellation) of any debts that were not paid in the liquidation of assets during the insolvency proceeding, except for public law debts, provided all the post-insolvency order claims and preferred claims have been satisfied in full. This is the so-called "fresh start" which has made its first appearance in Spanish law, although with restricted effects.

  According to the new reform, this remission or cancellation of debts is an effect that is also available to individuals who petition for an insolvency order without having previously tried to secure an out of court payments agreement, In this case the order

stipulating the completion of the insolvency proceeding will declare the remission of the unsatisfied debts under a more restrictive set of rules which will require the fulfillment of five conditions:

- the insolvency proceeding must be held to be non-culpable;
- the debtor must not have been convicted for the crime under article 260 of the Criminal Code (willfully causing or aggravating the insolvency);
- all of the post-insolvency order claims must have been satisfied;
- all of the preferred claims must have been satisfied (including with assets given in payment) and
- 25% of the general (unsecured) claims must have been satisfied.

Hermosilla, 3 - 28001 Madrid - Spain
Telephone +34 91 514 52 00 - Fax +34 91 399 24 08