Main new features that the reform of the Recast Insolvency Act has brought to the Spanish Restructuring and Insolvency rules

September 2022

The Act nº 16/2022, dated September 5, on the reform of the Recast Insolvency Act, published on September 6, 2022, brings deep and major changes to the existing legislation.

The amendment will come into force on September 26, 2022, twenty days after its publication, and affect both proceedings commencing after entry into force of the legislation and a few parts of proceedings that had commenced earlier.

The differences between the original bill and the approved insolvency reform are shown in the compared version available here.

Below we summarize the important new items of legislation in the new wording and how they will impact on the current insolvency legislation.

1. Restructuring plans

Implementation of restructuring plan

The Reform deeply alters the contents of Book II of the Recast Insolvency Act, by introducing restructuring plans which will replace the existing refinancing agreements (*acuerdos de refinanciación)* and out-of-court payment agreements (*acuerdos extrajudiciales de pago*). Restructuring plans will be able to be implemented from when the legal situation of probability of insolvency arises, although court sanction of plans that have not been approved by the shareholders requires the debtor to be in a situation of technical insolvency or imminent insolvency. It also provides that restructuring plans may imply the termination of executory contracts and of senior management employment contracts.

Contents of restructuring plans

The contents of restructuring plans are broader than those allowed for the current refinancing agreements, and may include the amendment or termination of collateral, for example. Along with the debtor's liabilities, these plans are also allowed to affect equity (by being binding on shareholders as we shall see) and assets, and may provide that, under the relevant non-insolvency legislation, transfers of assets or of business units may be made, or any operational changes (relating to employment, for example) needed to ensure the debtor's viability.

Court sanction of restructuring plans

Court sanction will be required for restructuring plans (i) where it is intended to impose the plan's terms on creditors or dissenting creditor classes, (ii) where it is intended to terminate contracts in the interests of the restructuring and, (iii) where it is intended to protect interim financing and fresh money.

Class formation and option of prior court confirmation

Affected creditors will have to be placed in classes based on a common interest which will be determined by reference to objective factors. The Reform states that creditors holding claims with equal rankings for the insolvency proceeding must belong to the same class, although they may be in separate classes if there are sufficient reasons justifying this (for example, depending on the treatment they receive or the existence of conflicts of interest). The law provides also that certain authorized parties may apply to the judge with territorial or international jurisdiction for sanctioning the plan for court confirmation of class formation ahead of the actual application for court sanction of the plan.

Approval of restructuring plans (intra-class cram-down mechanism)

The restructuring plan will be approved by a creditor class if it is supported by two thirds of the liabilities relating to that class, except for classes of creditors holding secured claims in which support by three quarters will be needed for approval.

Restructuring plans not approved by all creditor classes (cross-class cram-down mechanism)

For the first time in Spanish legislation, the Reform allows restructuring plans that have not been approved by all creditor classes and/or the shareholders to be sanctioned by the courts. Court sanction of plans not approved by all creditor classes will require: (i) the affirmative vote of a simple majority of classes, which must include a class with generally or specially preferred claims; or, failing that, (ii) approval by a class that would reasonably receive some form of payment following assessment of the debtor as a going concern. Moreover, for any plans not approved by shareholders the debtor will have to be in a situation of technical or imminent insolvency and, in particular, no class of affected shareholders will be able to receive rights or shares with a value greater than the amount of their claims.

Safeguard in the event of a cram-down of secured claims

The holders of secured claims belonging to a dissenting class will have, subject to certain requirements, a manner of separate enforcement right, to the extent of the collateral value and will lose the remaining portion of the claim, if any, not paid through enforcement.

Challenge against court sanction

The Reform provides that challenges against court sanctions must be heard by the provincial appellate court with jurisdiction (which alters the existing jurisdiction of commercial courts to hear both court sanctions and challenges against refinancing agreements).

A point to note is that the grounds for challenge vary depending on whether or not there has been a cross-class cram-down (in other words, they differ depending on whether or not they have been approved by all the affected classes, plus new safeguards are added in the first case such as the absolute priority rule.

Prior objection before court sanction

The Reform gives the applicant for court sanction (who may or may not be the debtor) the option to ask the commercial court with jurisdiction to allow the affected parties to submit an objection to the restructuring plan before it is sanctioned. That "*prior objection*" has to be handled in the procedure for an ancillary insolvency proceeding and the judgment settling it cannot be appealed.

Registration of acts for enforcement of the plan including where the sanction is not final

Acts for enforcement of a sanctioned restructuring plan, which have to be registered on public registers, may be registered even if the court sanction decision is not final.

Limited-scope challenge or objection

The Reform states that dissenting creditors may challenge or object to the sanction where (i) the necessary requirements to protect interim financing or fresh money have not been satisfied, (ii) where interim financing, fresh money or the acts specified for enforcement of the plan do not satisfy the legal requirements or unfairly prejudice the interests of creditors.

The confirmation of any of these grounds will give rise to the absence of protection in any potential subsequent insolvency proceeding against clawback action and to the absence of classification as preferred and post-insolvency order claims for interim financing and fresh money.

The restructuring expert: a new body in the restructuring plan rules

It is stated in relation to restructuring plans that a restructuring expert has to be appointed (i) where this is requested by the debtor, (ii) where this is requested by creditors representing more than fifty percent of the liabilities that might be affected by the plan, and (iii) where an application for court sanction is made for a plan that has not been approved by all creditor classes or the shareholders. In this last case, one of the expert's tasks will be to prepare a report on the debtor's value as a going concern.

Combined restructuring plans and synthetic restructuring plans

Combined restructuring plans are expressly allowed for groups of companies, as are synthetic restructuring plans, meaning those affecting companies that are guarantors of the group's debts, and these companies do not have to undergo a formal sanction procedure.

Pre-insolvency notice for a restructuring plan

The applicant is allowed to modulate the effects of the notice, plus a single extension of the pre-insolvency period is allowed.

Stay of voluntary insolvency petition

In certain cases, certain creditors or the restructuring expert are allowed to stay the procedure for handling any voluntary insolvency petition filed by the debtor, where the petition could prevent achievement of a restructuring plan.

Protection of claims subject to public law

A restructuring plan will not be able to determine for claims subject to public law, among other measures, a reduction to their amounts, a change of debtor or their conversion into instruments with different characteristics or a different ranking from those of the original claim. It is stated that any affected claims subject to public law must be paid *in full* (i) within twelve months from the date of the sanction decision, or (ii) within six months from the date of the sanction decision if payment of the affected claims had previously been deferred or split.

2. Pre-pack administration

Introduction of the concept of pre-pack administration

According to the Preamble to the Reform, the legislature has chosen to include in the insolvency legislation mechanisms for quick sales of business units that are available in other jurisdictions (the U.S. and the Netherlands, for example) so as to prevent business assets from losing value due to the debtor entering an insolvency proceeding. Briefly, the Reform allows the debtor to request, ahead of the insolvency order, the appointment of an expert to monitor the selection of a potential buyer for business units, so as to pave the way for the sale to take place more efficiently after the insolvency proceeding has commenced.

The Reform therefore contains a mechanism that has already been gradually accepted in practice through various protocols and court decisions, as we analyzed in the **pre-pack map**, published by the Restructuring and Insolvency Department.

Appointment of an expert to collect bids

The Reform envisages the appointment of an independent expert before the insolvency petition, who will have the task of collecting third parties' bids to buy one or more business units and who may or may not be confirmed as insolvency practitioners following the insolvency order.

That appointment may be requested by the debtor where there is a probability of insolvency, or it is in technical or imminent insolvency or even if the business unit has stopped operating. It is also stated that any such appointment will be secret.

Bid selection

The Reform allows, after the insolvency order has been delivered, any interested party to submit alternative proposals to that filed with the insolvency petition within a fifteen-day period. The insolvency practitioner will have to draw up a report on the submitted proposals and the judge will decide to approve the most favorable bid. Bidders will have to undertake to continue or resume operations for three years if the bid was filed after the insolvency order or for two years if the bid was that filed with the insolvency petition.

Submission of purchase bid by workers

The Reform allows the workers to submit a binding purchase bid by creating a cooperative, worker-owned or worker-invested company. The judge will have to give priority to this proposal by the workers if the bid is equal to or higher than the other alternatives that were submitted, subject to this satisfying the interests of the insolvency proceeding.

3. Arrangement with creditors

Disappearance of the advance proposal for an arrangement (*propuesta anticipada de convenio*) and simplification of the procedure for the end of the common pase

The Reform has done away with the advance proposal for an arrangement mechanism and simplified the steps in the procedure for commencement of the arrangement phase. Any proposal for an arrangement may be filed within fifteen days from when the insolvency practitioner's report is filed. In other words, if the parties entitled to do so have not filed a proposal within the time limit, a decree will be delivered ending the common phase and commencing the liquidation phase.

The time period for support or objection is two months from when it is admitted for consideration, which may be extended for up to a further two months at the debtor's request where there are justified reasons.

Disappearance of the creditors' meeting

The creditors' meeting has disappeared as a mechanism for giving consent to the proposal for an arrangement, and creditors are only able to do this by supporting the arrangement, with their signature by hand or electronically.

Amendment to debt rescheduling

A maximum ten-year debt rescheduling is allowed for all creditors and it is specified that the annual debt rescheduling time periods stipulated for unsecured claims will be computed as quarterly periods for subordinated creditors.

Structural modifications covenanted in arrangements

The Reform determines that proposals for an arrangement with structural modifications will have to be signed by sufficiently authorized representatives of the entities participating in the projected modifications.

It is also stated that the structural modification cannot result in a negative net equity figure for the absorbing company, the new company, the beneficiary companies of the spin-off or the transferee company.

The creditors' right to object has expressly been removed.

Lastly, it is stated that the registration of a merger, an absorption, a total spin-off and a transfer en bloc of assets and liabilities will be a ground for conclusion of the insolvency proceeding.

Objection against court approval of the arrangement

The Reform introduces creditors' superior interest as a ground for filing an objection against court approval of the arrangement, a ground which to date was needed to challenge court sanction of refinancing agreements.

Conversion of claims into shares

Company directors will be authorized, without having to obtain a resolution by the shareholders' meeting, to carry out the necessary capital increases to implement any arrangements that provide for the conversion of creditors' claims into the debtor company's shares, for which any preemptive rights held by the original shareholders will not apply either.

Moreover, it is stated that the new shares will be transferable without any restrictions for a ten-year period following registration of the increase at the commercial registry.

Option of amending the arrangement

The debtor is allowed to propose amending the arrangement after the first two years of its term; an application of this type will halt any others seeking a declaration of breach or seeking commencement of liquidation.

Subsequent liquidation commenced after the period for performance under the arrangement

It is stated that any claims falling due in the period for performance under the arrangement will be considered insolvency claims in a subsequent liquidation, instead of post-petition claims. Additionally, any acts detrimental to the assets of the debtor carried out in the two year period before an application for a declaration of breach or an application for commencement of liquidation may be clawed back under the rules stipulated for clawback action.

4. Insolvency proceedings without assets: "fast-track" insolvency proceedings (*concurso exprés*) disappear

The Reform replaces the option of simultaneously commencing and concluding insolvency proceedings with a system more closely monitored by creditors where the insolvent debtor evidences the existence of certain cases of insufficient assets.

The decision declaring an insolvency proceeding without assets, stating the liabilities, without any further pronouncements, is published in the Official State Gazette and at the Public Insolvency Registry and creditors representing at least five percent of the liabilities may apply for appointment of an insolvency practitioner to submit a report as to whether there are sufficient indications that the debtor carried out any acts detrimental to the assets which may be clawed back, so as to bring action for liability against the directors or liquidators or for the insolvency proceeding to be declared fault-based.

If the insolvency practitioner issues a report finding the existence of those indications, the judge has to deliver an additional decision with the other pronouncements for an insolvency order and commencement of the liquidation phase of assets available to creditors, and the proceeding will continue as determined in the law, in order to bring to Court claw-back actions.

5. Second chance mechanism (Spanish debt discharge system)

Eligibility requirements

Debtors' eligibility for the second chance mechanism is restricted by rules placing exceptions and prohibitions. The Reform adds to the good faith requirements contained in the previous legislation new exceptions to the right to obtain a discharge of debts and a fresh start, such as: (i) a final administrative penalty for serious tax, social security or labor infringements, or an enforcement of secondary liability against the debtor in the previous ten years; (ii) a decision declaring the debtor a person affected by the assessment of an insolvency proceeding on a third party as fault-based in the previous ten years; (iii) a breach by the debtor of the duty of disclosure and duty of cooperation with or to the judge and the insolvency practitioner; or (iv) the supply of false or misleading information, or reckless or negligent behavior by the debtor when entering into debts or verifying its obligations.

Liquidation or payments plan

The new fresh start mechanism pivots around two modular alternatives: (i) discharge under a payment plan; or (ii) discharge with liquidation of assets available to creditors.

The first is based on an assessment of the debtors' options afforded by its assets and rights for obtaining court approval of a plan for payment of dischargeable claims, including, for example,

payments of determined or determinable amounts or transfers of assets and rights in payment; the payments plan will have an overall term of three years and does not need prior liquidation of the debtor's assets and rights.

The second may arise principally where the insolvency proceeding concludes due to completion of the liquidation phase or due to insufficient assets available to creditors.

Foreclosure of principal residence

The payments plan option that the Reform has placed in the second chance rules allows debtors to keep their principal residence with a plan that may be for a term of up to five years. Creditors holding non-dischargeable claims, however, will always continue their action against the debtor and may apply for in or out of court enforcement of their claims (also against the principal residence).

Removal of the mandatory minimum amount

The Reform does away with the need to pay a minimum amount of claims to obtain discharge; payment of non-dischargeable claims is not even required, and they may continue to be claimed separately from the grant of a discharge.

Protection of claims subject to public law

Debts subject to public law will not be able to be discharged above certain thresholds. The first €5,000 will be able to be discharged in full whereas at or above that amount the discharge will be up to 50% of the debt. The maximum amount that may be discharged for each debtor is €10,000 for debts with AEAT, the Spanish tax agency, and €10,000 for social security claims.

6. Special procedure for micro-businesses

Bespoke proceeding

The Reform has crafted this new unique proceeding for micro-businesses due to failures encountered when implementing out of court payment agreements, and so creates a parallel insolvency system aimed at lowering costs. This system is quicker and more flexible with shorter time periods. The special rules for micro-businesses will not come into force until January 1, 2023.

The eligible parties included in the Reform Bill for the Recast Insolvency Act potentially stretched to a relatively large number of micro-businesses (debts or assets below €2,000,000 and fewer than 10 workers), which the finally approved wording has lowered to assets under €700,000 and debts under €350,000, while keeping the 10 worker maximum.

Own characteristics with secondary rules

The Reform clarifies that the provisions governing insolvency proceedings and pre-insolvency rules apply on a secondary basis to the special proceeding.

However, this proceeding has its own characteristics such as: its modular nature; the appointment of an insolvency practitioner not being mandatory; the handling of steps and notices in the proceeding through standard forms and electronically (use of the Cl@ve password); or the irrebuttable presumption of fault due to serious inaccuracy or misrepresentation in documents attached to the petition, among others.

Own specific pre-insolvency notice

Micro-businesses may use a pre-insolvency notice to try and achieve a continuity plan or a liquidation with transfer of the business as a going concern, subject to a few specific provisions consistent with the aims of this proceeding. Namely, the three month period for the effects of the notice will not be able to be extended and it will not be mandatory to appoint an independent expert at the debtor's request.

Two proceedings rolled into one

One of the major new features of this procedure is that it does not follow a linear sequence of phases as insolvency proceedings do. Instead, the debtor, creditors and shareholders (on satisfaction of the stipulated requirements) may choose either of two proceedings: **continuation** or **liquidation**.

The aim of the first option is to take forward a plan to secure the debtor's continuity, although it may be converted into a liquidation proceeding if requested by a given number of creditors.

The second option's aim is to approve a liquidation plan for the debtor's assets and rights, which has to be implemented in three months, a period that may be extended for a further month. The option of transferring the business unit flexibly is also given. The liquidation of assets and rights will be carried out on the **electronic liquidation platform** which will have to be brought into operation by the Ministry of Justice.

After the end of sixty working days from commencement of the liquidation proceeding, the option arises to commence an **abbreviated assessment section** following a request by the insolvency practitioner (if one exists); ten percent of the creditors; or the shareholders personally liable for the company's debts.

Specific characteristics of the continuity plan

Continuity plans are largely similar to restructuring plans in both the form of their approval (by the formation of creditor classes), in the options and flexibility regarding their contents, as well as in the grounds for challenging them.

Although the following particular characteristics need to be noted: (i) tacit votes are allowed, in other words, if a creditor fails to vote their vote will be counted as being in support of the proposal for the plan; (ii) tacit sanction is allowed (unless the majority has been obtained through the absence of votes); (iii) the absence of any submitted comments is considered to be tacit acceptance and prevents any subsequent challenge being made; and (iv) the absolute priority rule is replaced with the relative priority rule.

Protection of claims subject to public law

The Reform has included exceptions to ensure protection of public claims in special proceedings such as, for example, automatic commencement of the liquidation proceeding where more than eighty percent of the debtor's liabilities are composed of public claims or postponing collection of the insolvency practitioner's fees until preferred public claims are paid in certain events.

Contact our professionals

Adrián Thery
Partner
adrian.thery@garrigues.com

Borja García-Alamán
Partner
borja.garcia-alaman@garrigues.com

Juan Verdugo
Partner
juan.verdugo.garcia@garrigues.com

Juan María Jiménez
Partner
juan.maria.jimenez@garrigues.com

More information:

Restructuring and Insolvency Department

GARRIGUES

Hermosilla, 3
28001 Madrid
T +34 91 514 52 00
info@garrigues.com

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