AMENDMENT OF THE SPANISH INSOLVENCY LAW - CLIFFORD CHANCE

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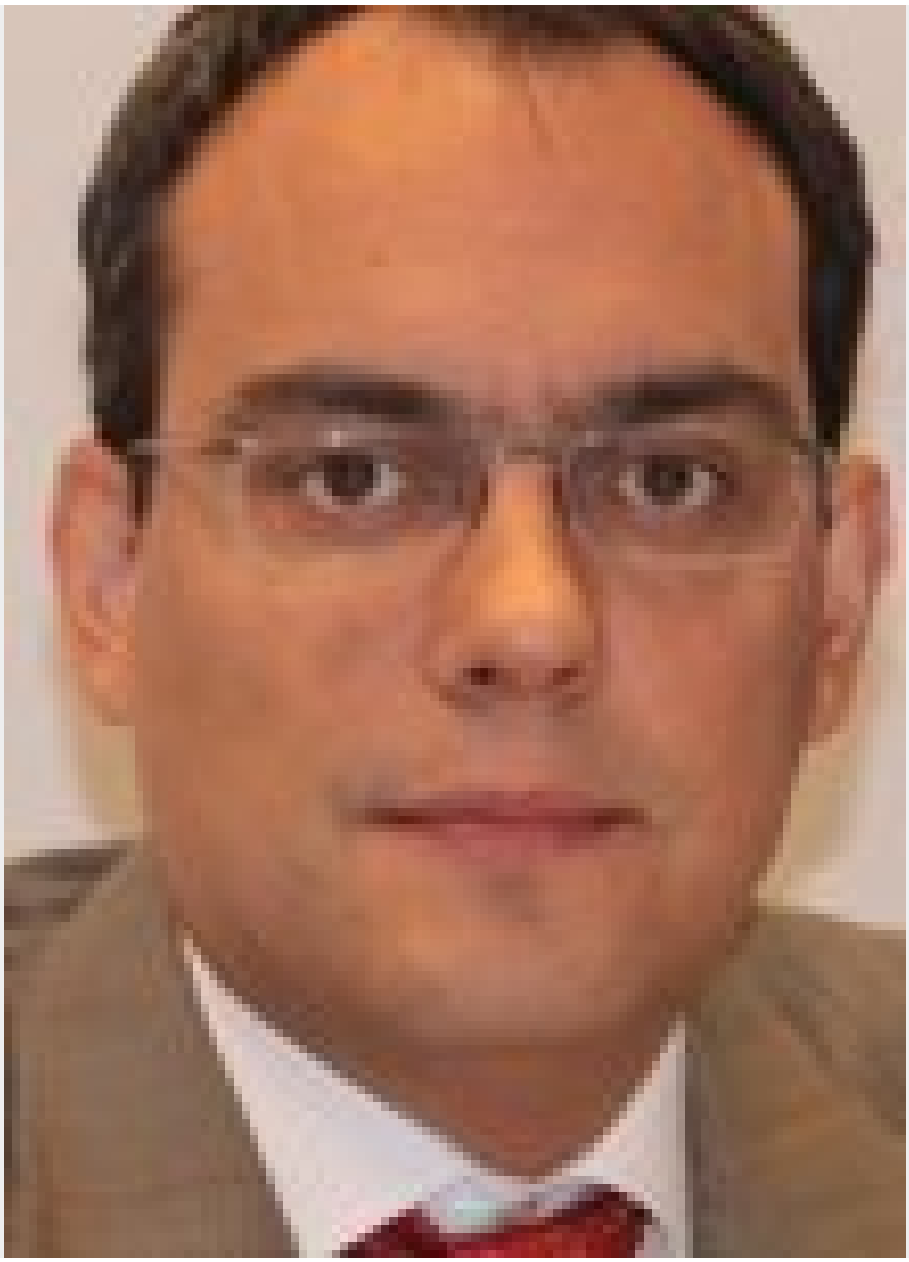

Category: Restructurings

The Law Amending the Spanish Insolvency Law was approved on 22 September 2011. As explained in its Preamble, the Amendment has a limited scope. It is not designed to overhaul the Insolvency Law, but rather to update it, correcting defects and filling in some gaps.

Insolvency practice has made it evident that the majority of proceedings end in liquidation, making it necessary to speed up the procedure and possibly avoid insolvency proceedings.

At first glance, the Amendment makes notable improvements to the insolvency process. At second glance, however, without denying the advancement which the approval mechanism for refinancing agreements entails, the reform falls short as its scopeit very limited. The most important changes are explained below.

Pre-insolvency restructuring mechanisms

The duty to initiate insolvency proceedings is not enforceable when a notification regarding the start of negotiations is presented (art. 5 bis) Article 5 bis of the Law contains the previous Article 5.3 of the Law, with the distinctions that had been added by case law:

The debtor (who does not need to accept an insolvency situation) may extend the deadline to comply with the legal obligation to file for insolvency by presenting a notification addressed to the Court authorised to hear its proceedings.
The notification may be used to negotiate a proposal for arrangement or a refinancing agreement which renders the application for insolvency unnecessary.
The notification does not oblige the debtor to provide any proof nor does it oblige the Court to carry out any verifications.

Approval of the refinancing agreements (Fourth Additional Provision)

The main change presented by the Amendment is the introduction of an approval mechanism for refinancing agreements, which is inspired in other legal systems, but is far from being an instrument for the novating financing agreements by a majority.

Agreement immune to the claw-back risk

This provision's starting point, which is its main determining factor, is the existence of a refinancing agreement stipulated in the Law's current Article 71.6 (which avoids the risk of claw-back), demanding that the following requirements be met:

- It must be formalised as a public deed.
- It must be approved by creditors representing at least 3/5 of the debtor's liabilities
- It must entail a significant extension of the credit or the modification of its obligations (for which the extension of the term suffices).
- It must correspond to a short- and medium-term feasibility plan.
- It must have received a favourable report from an expert appointed by the Mercantile Registry (this may be a single expert when the refinancing refers to a group of companies)

Agreement adopted by the majority of the debtor's liabilities

The refinancing agreement which acquires this "protective shield" effect as a result of the provisions of Article 71.6 must have the support of 75% of the financial liabilities.

Court approval

The refinancing agreement will be subject to approval by the Judge competent to declare the insolvency for the purposes which will be indicated below.

Through urgent proceedings, the Judge will verify that the above requirements have been met and approve the agreement, provided it does not represent a disproportionate sacrifice for the affected creditors who signed it.

Once approved, the affected creditors may file a challenge via incidental proceedings.

Effects of the agreement

The court approval of the agreement will have two effects:
In any case, the imposition of the agreed moratorium of debt on any affected creditors not holding an in rem guarantee.

If the Judge agrees (provisionally, upon granting the application leave to proceed, and definitively, upon approving the agreement) the imposition on the affected creditors of the prevention of enforcement actions during the grace period stipulated in the agreement, which may not exceed three years.

On the contrary, the approval does not reach:

On a subjective level, the non-financial creditors (i.e. providers) or creditors holding an *in rem* guarantee (which would be the majority in most cases); these will maintain their credits unaltered and would still be free to initiate actions.

On an objective level, the agreements other than the debt moratorium (i.e., debt cancellation, conversion of credit into capital, or the granting new financing) which will not bind the affected creditors.

Conclusion

The change which this mechanism entails is more theoretical than real. Its limited scope makes it quite unlike the pre-insolvency mechanisms established in other legislations. Nevertheless, it is a step forward in the sense that it constitutes the first pre-insolvency mechanism established in our legal system.

The collection preference for fresh money

Two collection preferences for fresh money are introduced in order to facilitate obtaining of financing by companies with financial difficulties:

Financing granted in the context of refinancing in accordance with Article 71.6 of the Law will be split into a credit against the insolvency estate and a credit enjoying a general privilege), in the event of subsequent insolvency proceedings.

Financing in the context of an agreement will be made against the insolvency estate if liquidation later arises (unless a specially related party had granted it).

Improvements made to the insolvency proceedings

Application and declaration of insolvency: necessary insolvency proceedings

When a creditor files for insolvency because it had unsuccessfully tried to seize assets, opposition

will not be admissible and the Judge will declare the insolvency on the following business day.

The instant creditor privilege will amount to 50% of its credit.

Corporate groups

Insolvency proceedings for companies in the same corporate group will be processed jointly from the beginning (at the applicant's request) or subsequently (at the request of the interested party). The joinder does not entail a consolidation of the insolvency estate unless there is a confusion of assets.

Statements of credits

Claims filed by creditors will be sent directly to the Insolvency Receivers and it will not be necessary to provide original documentation.The creditor must indicate an e-mail address.

Drafting the List of Creditors

A step preceding the presentation of the list has been introduced so that the Insolvency Receivers may correct errors, at the creditors' request.

As regards incidents where the List is challenged, hearings will be held exceptionally.

Initial stage

The sale of assets is permitted during the initial stage of the insolvency proceedings when it is required to continue carrying out the business (the Insolvency Receivers will notify the Court subsequently) or when it involves unnecessary assets and the bid is appropriate (in this scenario, provided that a better bid can be made).

Conclusion of the initial stage may be ordered when challenges affecting at least 20% of the assets or liabilities are still pending. This provision will only apply to insolvency proceedings underway when upon the Insolvency Receivers' Report has yet to be filed once the Amendment enters into force.

Ordinary and abbreviated proceedings

Ordinary proceedings will have an insolvency receiver (with legal or financial training) except in particularly important insolvency proceedings in which a creditor will also be appointed. Delegated assistants will be appointed in specific cases.

The abbreviated proceedings may be implemented by the Judge:

In insolvency proceedings dealing with small amounts as regards the liabilities (less than fifty creditors and 5 million euros) and the assets (less than 5 million euros). In any case it will be Judge's decision to choose the type of proceedings to follow.

When a rapid conclusion to the insolvency proceedings is sought: because there is a proposal for arrangement or a decision to liquidate.

End of the proceedings

This may be agreed at any time when it is verified that there are no (and there will not be any) assets to pay off the credits against the insolvency estate.

The proceedings can also be concluded when the insolvency situation no longer exists.4. Other aspects subject to the amendment.

Rescission

The following improvements have been made to Article 71.6 (formerly the Fourth Additional

Provision) on refinancing agreements immune to the claw-back risk:

The need to provide a single expert report for several companies in the same corporate group and the appropriateness in this scenario of verifying the majority of the liabilities both individually and en masse.

The need for the agreement's signatories to expressly evaluate the reservations or limitations established by the expert in his/her report.

Subordination of credits

The credits for specially related entities will not be subordinated when they do not abide by loans or acts of a similar purpose (i.e. the intra-group supplies).

Insolvency Receivers

Some improvements are made to the Insolvency Receivers regime (i.e. the appointment of professional companies), although an in-depth reform of its legal statutes has not undertaken.

Labour aspects

The procedure for the collective suspension, termination and modification of contracts has been updated.

Entry into force of the amendment of the insolvency law

The Law Amending the Spanish Insolvency Law will enter into force on 1 January 2012, with the exception of some provisions which will enter into force upon its publication.In general, entry into force involves the application of the Amendment to new insolvency proceedings filed as from that time, although most of its provisions will be exceptionally applied to proceedings which are already underway.

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