Pérez-Llorca

Special Information Briefing
COVID-19 (No. 15):

Insolvency and corporate measures adopted by Royal Decree-law 16/2020 of 28 April on procedural and organisational measures to address COVID-19 in the area of the administration of justice

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On 29 April 2020, Royal Decree-law 16/2020 of 28 April, on procedural and organisational measures to address COVID-19 in the area of the Administration of Justice (**"RDL 16/2020"**) was published in the Official State Bulletin (**"BOE"**).

Specifically in the area of insolvency, RDL 16/2020 adopts a series of measures that complement those established by Royal Decree-law 11/2020 of 31 March, adopting additional urgent social and economic measures to deal with COVID-19 (**"RDL 11/2020"**)[1], in view of the additional difficulties, arising from the COVID-19 health crisis, affecting the viability of companies.

The purpose of these measures is to temporarily and exceptionally mitigate the consequences of applying the general rules on the dissolution of limited companies and on the declaration of insolvency in the current situation, by avoiding declarations of insolvency or, where appropriate, opening the liquidation phase with regard to companies that could be viable under general market conditions after the COVID-19 crisis has been dealt with, by restructuring their debt, obtaining liquidity and offsetting losses, either through the recovery of their ordinary activity or through access to credit or public aid.

This new package of insolvency-related measures can be divided into three blocks, depending on their aims: (i) measures to maintain the economic continuity of companies, professionals and self-employed persons who, prior to the entry into force of the state of alarm, had regularly fulfilled the obligations arising from a composition agreement, out-of-court payment settlement or approved refinancing agreement; (ii) measures to promote and incentivise the financing of companies to meet their temporary liquidity needs; and (iii) measures to expedite the processing of insolvency proceedings in view of the foreseeable increase in litigation in this area.

In terms of corporate measures, two rules have been established which temporarily and exceptionally replace the application of the general rules on the dissolution of limited companies and on the declaration opening insolvency proceedings, namely: (i) the suspension of the duty to file for insolvency until 31 December 2020; and (ii) the provision that, for the purposes of the legal grounds for dissolution due to losses, the profits or losses for the current financial year will not be counted[2].

[1] Among other things, in the area of insolvency, RDL 11/2020 establishes a series of amendments in relation to the suspension of employment contracts and reductions of working hours, in order to extend to insolvent companies the possibility of accessing a temporary workforce restructuring plan under the terms of Royal Decree-law 8/2020, of 17 March, on extraordinary urgent measures to deal with the economic and social impact of COVID-19 ("**RDL 8/2020**").

[2] To this end, article 43 of RDL 8/2020 –which established the suspension of the duty to file for insolvency during the state of alarm and provided that the Commercial Court would not admit applications for compulsory insolvency for consideration until two months following the end of the state of alarm– has been revoked.

1. Measures to maintain the economic continuity of companies

In order to promote and protect the economic continuity of companies, RDL 16/2020 establishes in favour of the debtor (and, if applicable, the insolvent entity): (i) the possibility of submitting a proposal to amend the composition agreement undergoing the compliance stage; (ii) the deferral of the admission of applications for a declaration of breach of the composition agreement; (iii) the deferral of the duty to apply for the opening of the liquidation phase; (iv) the possibility of amending or submitting a new refinancing agreement; and (v) a special regime for filing for insolvency.

A. Possibility of submitting proposals to amend the composition agreement

In order to adjust the content of the composition agreement to the debtors' economic difficulties in meeting the agreed payments due to the COVID-19 crisis, and to facilitate their compliance, RDL 16/2020 grants the debtor the power to present a proposal to amend the composition agreement undergoing the compliance stage.

The ability to exercise this right would be limited to the year following the declaration of the state of alarm.

To this end, the debtor must file a request for amendment of the composition agreement, accompanied by: (i) a list of outstanding payments; (ii) a viability plan; and (iii) a payment plan.

The amendment proposal will be processed in accordance with the rules established for the approval of the original composition agreement, although it will be processed in writing, regardless of the number of creditors.

The majorities of the liabilities required for acceptance of the amendment proposal will be the same as those required for acceptance of the original composition agreement proposal[3], irrespective of the content of the amendment.

The amendment will not affect, under any circumstances: (i) claims accrued or incurred during the period of compliance of the original agreement; nor (ii) creditors with preferential claims to whom the effectiveness of the composition agreement has been extended or who have accede to the composition agreement once it has been approved, unless they vote in favour of or expressly support the amendment proposal.

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[3]These majorities are: (i) 50% of the ordinary liabilities, when the composition agreement proposal contains debt write-offs equal to or less than half the amount of the credits; moratoriums for a maximum period of five years; or, in the case of creditors other than public or labour creditors, the conversion of debt into equity loans during the same term; or (ii) 65% of the ordinary liabilities, if write-offs exceed 50% of the claimed amounts, or moratoriums of more than five years, or the conversion of debt into equity loans during the same term are foreseen (in the case of creditors other than public or labour creditors, based on article 124 of the Insolvency Act)

B. Deferral of admission for processing of applications for the declaration of breach of the composition agreement

In addition, in order to support companies that could be viable under general market conditions, and whose ability to comply with the composition agreement has been affected by the COVID-19 crisis, a measure consisting of providing the debtor with the opportunity to submit a proposal to amend the composition agreement in the event that a creditor submits a request for a declaration of breach of the composition agreement has been established.

To this end, if within six months of the declaration of the state of alarm, a creditor submits an application for a declaration of breach of the composition agreement, the Commercial Court will transfer the application to the debtor without admitting it for consideration until three months have elapsed since the end of that period. During those three months, the debtor may submit a proposal to amend the composition agreement, which will be processed in preference to the application for a declaration of breach.

C. Deferral of the duty to request the opening of the liquidation phase

A third measure designed to help companies that could be viable under general market conditions is to relax the requirements for compliance with the composition agreement – the breach of which would normally lead to the opening of the liquidation phase[4]– by suspending, for a period of one year following the declaration of the state of alarm, the duty of the debtor to request liquidation of the estate when they become aware of the impossibility of fulfilling the agreed payments or obligations undertaken following the approval of the composition agreement, provided that the debtor submits a proposal to amend the composition agreement and that it is admitted for processing within that period[5]. If requests for liquidation have been made by the debtor following the declaration opening insolvency proceedings prior to the entry into force of RDL 16/2020, the Commercial Court will not consider them if the debtor files the amendment of the composition agreement.

Furthermore, during the same period, even if the creditor proves the existence of some of the facts that may support the declaration of insolvency during this period, and which would lead to the opening of liquidation, the Commercial Court will not issue an order opening the liquidation phase.

D. Measures relating to refinancing agreements

RDL 16/2020 also provides measures to strengthen judicially approved refinancing agreements. Thus, during the one-year period following the declaration of the state of alarm, the debtor who has an approved refinancing agreement may inform the competent court that

[4] Articles 142 and 143 of the Insolvency Act.
[5] The proposal to amend the composition agreement will be processed under the terms of RDL 16/2020.

they have initiated or intend to initiate negotiations with creditors to amend the agreement in force or to reach a new one, even if one year has not passed since the previous request for approval.

In addition, during the six months following the declaration of the state of alarm, the Commercial Court will notify the debtor of any applications for a declaration of breach of the refinancing agreement submitted by the creditors, but will not admit them for processing until one month has elapsed following the end of this six-month period. During that month, the debtor may notify the Commercial Court that they have commenced or intend to commence negotiations with creditors to amend the existing approved agreement or to reach a new one, and a period of three months will be granted for the agreement to be reached. If they do not do so within that period, the Commercial Court will consider the applications for declaration of breach filed by the creditors.

E. Special arrangements for filing for insolvency

Elsewhere, with the intention of avoiding declarations opening insolvency proceedings for companies that could be viable under general market conditions after the COVID-19 crisis has been dealt with, RDL 16/2020, after repealing the regime provided for in article 43 of RDL 8/2020, approves the suspension, until 31 December 2020, of the duty of debtors in a state of insolvency to request the declaration opening insolvency proceedings[6], regardless of whether they have given the notification provided for in article 5 bis of the Insolvency Act[7].

As a consequence of the above, the Commercial Court will not consider applications for compulsory insolvency submitted following the declaration of the state of alarm until 31 December 2020. However, applications for voluntary insolvency submitted during this period will be processed in preference to the applications for compulsory insolvency, even if they are submitted after the application for compulsory insolvency.

Lastly, if before 30 September 2020 the debtor gives notification of the opening of negotiations with creditors in order to reach a refinancing agreement, an out-of-court payment settlement or to obtain support for a proposal for an early composition agreement, the general regime established by law will apply.

[6] Under normal conditions, the debtor has the duty to request the declaration opening insolvency proceedings within two months of the date on which they became aware or should have been aware of their state of insolvency, i.e. that they cannot fulfil their obligations on a regular basis, in accordance with the provisions of articles 2 and 5 of the Insolvency Act.
[7] This is the notification through which the debtor makes the competent court aware for the declaration of the opening of negotiations with creditors to reach a refinancing agreement, an out-of-court payment settlement or support for a proposal for an early composition agreement.

2. Measures to promote and incentivise the financing of companies

The second block of measures adopted by RDL 16/2020 is aimed at promoting and incentivising the financing of companies in order to facilitate credit and liquidity, by modifying the classification of claims in certain cases, as will be seen below.

A. Claims arising from financing commitments or the granting of guarantees by third parties to be classified as claims against the estate

RDL 16/2020 establishes that, in the event of a breach of the approved or amended composition agreement within two years of the declaration of the state of alarm, claims arising from any financing granted to the debtor or any guarantee granted in favour of the debtor by any person, including persons who are especially related to the debtor, will be classified as claims against the estate as long as they appear in the composition agreement proposal or in the proposal to amend the composition agreement already approved by the Commercial Court[8].

B. Claims by persons who are especially related to the debtor for financing and payments on behalf of the debtor to be classified as ordinary claims

In addition, in order to encourage financing and payments to companies affected by the COVID-19 crisis, the following will be considered ordinary claims in insolvency proceedings declared within two years of the declaration of the state of alarm[9]: (i) claims arising from financing operations granted since the declaration of the state of alarm by persons who are especially related to the debtor[10]; and (ii) claims in which persons who are especially related to the debtor have been subrogated as a result of payments of ordinary or preferential claims made on behalf of the debtor, since the declaration of the state of alarm.

3. Measures to expedite the processing of insolvency proceedings

Lastly, a series of rules are established to expedite the insolvency process, such as preferential processing of certain actions aimed at protecting workers' rights, business continuity and preserving the value of assets and rights, as well as the simplification of certain acts and insolvency procedural pleas.

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[8] To this end, the identity of the obligor and the maximum amount of the financing or guarantee to be provided must appear in the composition agreement proposal or the proposal for the amendment of the composition agreement already approved by the Commercial Court.

[9] In normal circumstances, these claims would be considered subordinated claims, in accordance with the provisions of article 92 of the Insolvency Act.

[10] By virtue of article 93.2 of the Insolvency Act, the following persons are considered to be especially related to the insolvent legal entity: (i) partners (subject to certain conditions); (ii) de jure or de facto directors, the liquidators of the insolvent legal entity and representatives of the company who hold general powers of attorney, as well as those who had this role within the two years prior to filing for insolvency; and (iii) companies forming part of the same group as the company undergoing insolvency proceedings and their common partners.

A. Preferential processing

To expedite the insolvency proceedings, preferential processing is established for a series of actions that take place within the year following the declaration of the state of alarm, namely: (i) insolvency procedural pleas in labour matters; (ii) actions aimed at the disposal of business units or the lump sale of assets; (iii) composition agreement proposals or proposals for the amendment of composition agreements; (iv) insolvency procedural pleas opposing judicial approval of the composition agreement; (v) insolvency procedural pleas regarding clawback actions; (vi) admission of the petition for approval of a refinancing agreement or amendment of the agreement in force; and (vii) adoption of interim measures.

B. Simplification of procedural acts

Additionally, the following measures have been adopted to expedite insolvency proceedings in various phases.

(i) Challenging the inventory and the list of creditors

For insolvency proceedings in which the insolvency administrator has not yet presented the provisional inventory and the provisional list of creditors and for those which are declared within two years of the declaration of the state of alarm, insolvency procedural pleas which challenge the inventory and the list of creditors are simplified, admitting as evidence only documentary and expert evidence, which must accompany the challenge and the defence thereof, thus eliminating the need to process a hearing (unless the Commercial Court decides otherwise).

Failure by any of the defendants to respond to the claim shall be considered as acceptance, except in the case of public institutional creditors.

(ii) Liquidation of the estate

In order to speed up the liquidation of the assets of the estate in relation to insolvency proceedings that are declared within the year following the declaration of the state of alarm and those that are being processed on that date, RDL 16/2020 establishes that auctions of assets and rights of the estate must be out-of-court auctions, even if the liquidation plan establishes otherwise.

As an exception to the above, it is established that in any stage of the insolvency proceedings: (i) the sale of the company as a whole or of one or more business units may be carried out either by judicial auction, out-of-court auction, or by any other means of sale authorised by the Commercial Court from among those provided for in the Insolvency Act; and (ii) if, at any stage of the insolvency proceedings, the Commercial Court

authorises the direct sale of the assets and rights subject to special privilege, *deed-in-lieu*, or for payment of such assets, the terms contained in such authorisation will apply.

(iii) Approval of the Liquidation Plan

With a view to expediting the process of approving the liquidation plan once the state of alarm is no longer in force, RDL 16/2020 establishes that the Commercial Court must issue an order immediately - either approving the liquidation plan, including any amendments deemed necessary, or agreeing to the liquidation in accordance with the supplementary legal rules - fifteen days after the liquidation plan has been evidenced in the court office.

(iv) Expediting the processing of the out-of-court payment settlement

In relation to the processing of the out-of-court payment settlement, and for the purposes of initiating consecutive insolvency proceedings, RDL 16/2020 establishes that, during the year following the declaration of the state of alarm, the out-of-court payment settlement will be considered to have been attempted by the debtor without success, by communicating and evidencing before the Commercial Court that there have been two instances of the insolvency mediator to be appointed not accepting the role.

4. Corporate measures: suspension of the grounds for dissolution due to losses

Lastly, the application of the regulations provided in the Spanish Companies Act, on the dissolution of limited companies and the declaration of insolvency, has been replaced. It is established that losses in the 2020 financial year will not count for the sole purpose of determining whether there are grounds to dissolve the company because its net worth has been reduced to less than half of the share capital.

If the outcome for 2021 shows losses that reduce the net worth to less than half of the share capital, the directors must call a general shareholder's meeting, or any shareholder may request such a meeting, within two months of the end of the financial year in order to dissolve the company, unless the capital is sufficiently increased or reduced.

The above is without prejudice to the obligation to file for insolvency in accordance with the provisions of RDL 16/2020.

5. Tax effects of corporate measures: grounds for exclusion from the tax group of entities with unbalanced assets

The measure provided for in article 18 of RDL 16/2020, which suspends the obligation to dissolve due to losses, also has significant implications from a tax point of view.

Article 58.4.d) of Law 27/2014, of 27 November, on Corporate Income Tax, establishes that entities which, at the end of a given tax period (year N), are in the commercial situation of imbalance of assets regulated in the aforementioned article 363.1.e) of the Spanish Companies Act, may not form part of a corporate income tax consolidation group, unless this situation has been remedied before the end of the following tax period (year N+1). Exclusion from the tax group takes effect from the first year in which the imbalance occurred.

The consequences of an entity being excluded from a tax group can be very significant: they can range from the obligation to incorporate deferred intra-group revenue (and to pay tax on it) to the tax consolidation group being broken up if it is the parent entity of the tax group that finds itself in this situation.

Given that the definition of the grounds for exclusion from the tax group is made by reference to the aforementioned article 363.1.e) of the Spanish Companies Act, to the extent that article 18 of RDL 16/2020 establishes an exceptional calculation rule for the purposes of the application of said article, we consider that the effect of RDL 16/2020 will be automatically extended to the regulations governing the Corporate Income Tax consolidation regime.

This was the interpretation of the regulatory precedent of article 18 of RDL 16/2020, namely the Sole Additional Provision of Royal Decree 10/2008, of 12 December, which eliminated from the calculation for the purposes of dissolution due to impairment losses of property, plant and equipment, investment property and inventories. This regulation was analysed by the General Directorate of Taxes in its ruling V0804-11, of 29 March, in which it stated that "*This same rule must be extended for the purposes of the application of article 67.4.b) of the Consolidated Text of the Corporate Income Tax Act, as the sole additional provision of Royal Decree-law 10/2008 amends the grounds for dissolution provided for in article 260.1.4 of the Consolidated Text of the Spanish Corporations Act. That is, impairment losses relating to property, plant and equipment, investment property and inventories are not taken into account when determining whether the requirements of article 260.1.4 of the Consolidated Text of the Spanish Corporations Act are met, nor for the purposes of excluding a company from a tax group under the terms established in article 67.4 of the Consolidated Text of the Corporate Income Tax Act*".

Consequently, the same criterion may be applied in respect of article 18 of RDL 16/2020 and, therefore, in terms of the practical results, for tax purposes this measure will have the effect that the entities affected will have two years to remedy the situation rather than one. After this period, if the situation is not remedied, they will be excluded from the tax consolidation group.