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New developments in the Reform of the Insolvency Act

On 14 January 2022, the Draft Law on the Reform of the Insolvency Act was published in the Official Gazette of the Spanish Parliament with the aim of transposing into Spanish law Directive (EU) 2019/1023 of the European Parliament and of the Council on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (the **"Directive"**).

This legal briefing analyses the most significant developments that will be introduced in insolvency legislation through this new law, which is due to be passed soon (the **"Insolvency Reform Act"** or the **"Insolvency Reform"**). The Insolvency Reform Act is a true remodelling of the insolvency legal system; and, according to its Explanatory Memorandum, its purpose is to provide solutions to the limitations and inefficiencies of the current system.

The analysis of the key amendments introduced by the Insolvency Reform Act has been divided into two main sections: (i) the reforms introduced concerning pre-insolvency law; and (ii) the reforms introduced concerning insolvency proceedings. This legal briefing also considers the special procedures for small and medium-sized enterprises and micro-enterprises, the second chance regime and express insolvency proceedings.

1. Key reforms in pre-insolvency law: restructuring plans

Pre-insolvency law is being thoroughly reformed. The Insolvency Reform includes the introduction of restructuring plans, which replace refinancing agreements and out-of-court payment agreements.

These restructuring plans are intended to help resolve over-indebtedness in the company at an early stage of the crisis. To this end, a pre-insolvency state is included, in addition to the existing states of current or imminent insolvency. It will be known as a likelihood of insolvency, which is defined as a situation in which it is objectively foreseeable that the debtor will not be able to meet its obligations falling due within the next two years.

The main features of the new restructuring plans are as follows:

(i) Content of the restructuring plan

Restructuring plans may affect not only the debtor's liabilities, but also its assets and equity. This may involve the sale of a business unit or even the entire company, or the termination of contracts with outstanding reciprocal obligations, provided that this is in the interest of the restructuring. Similarly, in terms of liabilities, the effects of restructuring plans may extend to commercial creditors, public law creditors, under certain circumstances, and even the debtor's shareholders.

It is foreseen that if, as a result of the capitalisation of claims, there is a change of control of the company, the contractual clauses on change of control that the company may have agreed for situations of continuity of business activity will not apply.

Along with the traditional effects that could be included in refinancing agreements, restructuring plans may involve the modification or termination of collateral, a change in the person of the debtor or a change in the law applicable to the credit.

(ii) The requirements for approval of the restructuring plan

(a) Creditors should be grouped into classes. A wide margin is given to determine the classes of creditors, with maxims such as common interest, equality of rank and the type of claim. Public law claims are always a separate class among the classes of the same insolvency rank.

(b) The restructuring plan can only affect public-law claims if the debtor is up to date with payments to the Tax Authorities and the Social Security.

(c) Approval of the plan within each class will require (i) in the case of unsecured classes, a vote in favour of two-thirds of the liabilities; and (ii) in the case of classes including secured claims, a vote in favour of three-quarters of the liabilities.

(d) If the plan involves claims governed by syndication agreements, the contractual arrangements on voting rights must be respected.

(e) It may be possible for the restructuring plan to be approved by all the classes concerned. Otherwise, cross-class cram down is possible (i) if the plan is approved by a majority of the classes provided that at least one class is privileged, or (ii) if the plan is approved by at least one class that would presumably receive some payment upon valuation of the company as a going concern.

(f) The plan may also be approved even if it includes measures requiring approval at the shareholders' meeting, provided that the debtor is in a situation of actual or imminent insolvency (not likely insolvency).

(iii) *Ex ante* confirmation of classes of creditors

Both the debtor and the majority of creditors potentially affected by the restructuring plan may apply to the Commercial Court for confirmation of the classes already formed, prior to the approval of the plan. Should this happen, the restructuring plan may not be challenged after its approval on this ground.

(iv) Power to extend the effects of the restructuring plan

The power to extend the effects of the restructuring plan to dissenting creditors within a class is enhanced. This extension of effects or cram down power can also take place in respect of entire classes of creditors. In order for the extension of effects to take place, the restructuring plan must have been approved by the court.

(v) Judicial approval of the restructuring plan

Judicial approval of the restructuring plan will be required if it seeks to: (a) extend its effects to dissenting creditors, classes of creditors or shareholders; (b) terminate contracts in the interest of the restructuring; and (c) protect interim and new financing expected to be obtained under the restructuring plan, as well as acts or businesses related to the plan, from potential revocatory actions.

For the restructuring plan to be approved, it will be necessary to reasonably justify that it pursues the aim of avoiding insolvency and ensuring the debtor's viability in the short and medium term. This is provided that the financial sacrifice imposed on the creditors is proportional to the

aforementioned purposes. There are also a number of requirements as to content and form and regarding claims of the same class being treated equally.

The rules of the best interest of creditors and absolute priority are incorporated. The rule of the best interest of creditors must always and in any case be respected. The rule of absolute priority can only be exempted if the debtor's viability requires it and the harm to the affected claims is not unjustified.

(vi) Regime for challenging the restructuring plan

(a) If requested by the applicant for judicial approval, opposition to the judicial approval of the plan may be lodged in advance with the Commercial Court. The judgment given on the basis of the objection cannot be appealed.

(b) If the applicant for approval does not make the above request, the order approving the restructuring plan may be challenged before the Court of Appeal.

The grounds for opposition or challenge are the same and include the rule of the best interest of the creditors. Under this rule, creditors may challenge or oppose the restructuring plan if they can demonstrate that they would have been better off in a hypothetical liquidation that would have taken place two years after the approval of the restructuring plan than under the terms of the plan.

In the case of plans that have been approved without the favourable vote of all classes, creditors may claim a violation of the rules on parity of treatment of creditors, including the absolute priority rule.

Other grounds for challenge include the failure to communicate the plan to creditors, failure to form classes and approve the plan, the debtor not being insolvent or likely to become insolvent, or the failure to ensure the debtor's viability in the short or medium term.

The shareholders may also challenge the judicial approval of the restructuring plan.

The challenge does not have a suspensive effect. The judgment upholding the challenge will only affect the parties challenging the plan, to whom the effects of the plan will not be extended. The plan will only be declared ineffective if it is declared that the necessary majorities are not present or that the classes have been formed incorrectly.

(vii) Effects of the communication of the commencement of negotiations

In addition to the traditional effects on enforcement, it is possible to stop the enforcement of guarantees provided by group companies that have not submitted the communication if it is proven that the enforcement of the guarantee may cause the insolvency of the guarantor and the debtor. The suspension of enforcement proceedings initiated by public creditors will not be applicable. Such enforcement may only be suspended at the realisation or disposal phase when it concerns assets or rights necessary for the continuation of the debtor's business or professional activity. The suspension will be effective for three months from the day of the communication of the commencement of negotiations.

The decision on the suspension of enforcement is independent of the decision by which the communication of the commencement of negotiations is deemed to have been made, and may only be appealed against by way of an appeal for reconsideration.

The Insolvency Reform includes two important developments:

(a) The legal duty to promote the dissolution of the company in the event of serious losses that leave the net assets reduced to less than half of the share capital during the period of the negotiations is suspended; and

(b) the Commercial Court may, at the request of the debtor or the restructuring expert, suspend an application for insolvency proceedings that has already been lodged if it is demonstrated that the restructuring plan is likely to be approved.

The communication of the commencement of negotiations does not affect the validity of contracts with outstanding reciprocal obligations. Indeed, any contractual clause to the contrary will be deemed not to have been put in place (without prejudice to the fact that the restructuring plan may provide for the termination of such contracts in the interest of the restructuring).

A number of special provisions are established in relation to certain types of contracts, such as contracts for the supply of goods, services or energy necessary for the continuity of the debtor's business or professional activity. These contracts may not be prematurely expired, terminated or otherwise ended, unless they are traded on organised markets, so that they can be replaced by another at any time at market value.

The effects of the communication will last for three months, plus an additional three-month period that may be granted as an extension, if the majority of the liabilities affected by the plan and the restructuring expert support such a request. The extension will be subject to registration in the Public Insolvency Register, even if the communication of the commencement of negotiations has been made on a confidential basis.

(viii) The restructuring expert in the framework of the judicial approval of the restructuring plans

Provision is made for the appointment of a restructuring expert where the effects of the plan for which judicial approval is sought will extend to one or more classes of creditors or to dissenting shareholders, where their vote is required under company law. The expert may also be appointed at the request of the debtor, by a majority of the creditors affected by the plan or by the Commercial Court if enforcement is generally suspended to safeguard the interest of the parties affected by the suspension.

The expert will be subject to duties of care, independence and impartiality, and subject to civil liability. Furthermore, a person who has been appointed as a restructuring expert may not subsequently be appointed as the insolvency administrator of the same debtor.

(ix) Protection of funding

Mechanisms for the protection of interim financing during the period of negotiations of the restructuring plan are provided for, as well as mechanisms for the protection of the new financing necessary for the implementation of the plan. These mechanisms are provided for in situations where insolvency proceedings are subsequently declared, and provided that the plan has been judicially approved.

Protection against potential revocatory actions (provided that the plan affects at least 51% of the total liabilities, or 60% if the financing is provided by persons especially related to the debtor), as well as preference in collection.

2. Key reforms in insolvency proceedings

The reforms introduced in insolvency proceedings are aimed at streamlining the procedure and adapting it to the characteristics of small and medium-sized enterprises. The reforms can be divided into the following categories: (i) procedural reforms; and (ii) reforms in the liability phase.

2.1. Procedural reforms

The Insolvency Reform includes measures to streamline insolvency proceedings. The following reforms are particularly noteworthy:

(i) Limitation of the maximum duration of the proceedings

The insolvency proceedings cannot last longer than twelve months from their declaration until the end of the liquidation. The Commercial Court may grant extensions of the time limit depending on the complexity or special circumstances that may arise in the insolvency proceedings.

The limitation of the duration of the insolvency proceedings is linked to the remuneration of the insolvency administration. Therefore, (a) if the common or composition phase lasts longer than six months, the insolvency administration's remuneration will be reduced by 50%; and (b) if the liquidation phase lasts longer than eight months, the insolvency administration's remuneration will also be reduced by at least 50%. In all cases, the Commercial Court may derogate from this rule if, in a reasoned manner, it considers that there are objective circumstances that justify the delay or that the insolvency administration has diligently fulfilled its duties.

(ii) On filing for insolvency

It is provided that bids for the acquisition of business units can be submitted as soon as the request for insolvency is submitted. The debtor is also empowered to submit binding proposals for the acquisition of business units. These measures are aimed at achieving the early sale of business units.

(iii) Sale of business units in insolvency proceedings

Provision is made for the debtor to request the appointment of an expert to collect bids for the acquisition, with cash payment, of one or more business units. The Commercial Court will determine the duration of the position and the expert's remuneration, taking into account the value of the business unit or units.

The acquirer of the business unit must maintain or restart the activity of the business units acquired for at least three years. Failure to comply with this obligation will entitle any injured party to claim damages from the acquirer of the business unit.

(iv) On the composition agreement with creditors

The Insolvency Reform provides for the need to opt for liquidation or composition with creditors in the provisional report of the insolvency administrator.

In addition, the possibility to file an early composition agreement or to hold a creditors' meeting is abolished and replaced by written accessions. The time limit for creditors to accede to or oppose the composition agreement is two months. However, if there is a justified and proven cause, the Commercial Court may, at the debtor's request, grant an

extension of this time limit. This extension will be for a maximum of two months from the end of the originally granted deadline for accessions.

(v) On liquidation

Liquidation plans are to be eliminated. To replace them, the Insolvency Reform provides for general liquidation rules. Likewise, the Commercial Court will be empowered to establish a series of special rules for the liquidation, following a hearing or a report from the insolvency administration. The special rules may be modified by the judge subsequently, ex officio or at the request of the insolvency administration. The insolvency administration will carry out the liquidation in accordance with these general rules or, where appropriate, in accordance with the special rules established by the Commercial Court.

2.2. Reforms in the liability phase

The key aspects of the Insolvency Reform in the liability phase can be summarised as follows:

(i) The opening of the liability phase is brought forward, which will take place with the end of the common phase so that it will not be necessary to wait for the approval of the liquidation plan or the judgment approving a burdensome composition agreement.

(ii) A more active role for creditors is envisaged. In this regard, creditors may make submissions to the insolvency administration with their allegations regarding the liability of the insolvency proceedings, during the period granted for the communication of claims.

Similarly, within ten days of the submission of the liability report by the insolvency administration, creditors who have previously made allegations and who represent at least 5% of the liabilities or who are holders of loans in excess of one million euros may also submit liability reports and request the declaration of liability of the insolvency.

Finally, the participation of the Public Prosecutor's Office is eliminated. Thus, the Commercial Court will only bring the reports to his attention if they reveal a possible criminal offence that cannot be prosecuted solely at the request of the aggrieved person.

(iii) The grounds for liability are the same, but a new rebuttable presumption of liability is introduced, consisting of the debtor's failure to claim the payment of outstanding obligations in the event of a breach of the composition agreement.

(iv) The Insolvency Reform also includes procedural modifications within the liability phase:

(a) The judgment rejecting the insolvency administrator's request for the insolvency proceedings to be dismissed may only include an order for costs in the event of recklessness. No express mention is made of cases in which it is the creditors who have requested the insolvency proceedings.

Similarly, a judgment declaring the insolvency liable will not include an order for costs for the persons affected by the liability.

(b) Provision is made for the possibility of compromising the classification component as regards its economic content. Before the approval of the settlement, the parties to the classification phase must be given notice to submit their observations. The resolution approving the settlement shall be subject to appeal.

3. Special procedures for small businesses

To make the insolvency process more efficient, two specific regimes are created: (i) a special regime on restructuring plans for small companies; and (ii) a special regime for micro-enterprises.

3.1. The special regime for the adoption of restructuring plans for small businesses

This scheme shall apply to natural or legal persons carrying on a business or professional activity, provided that they have fewer than forty-nine employees and their turnover does not exceed 10,000,000 euros.

This regime shall not apply to companies belonging to a group obliged to consolidate accounts; nor to debtors having the status of micro-enterprises.

A number of specific details are established both in terms of communication of the existence of negotiations with creditors, and in relation to the restructuring plans themselves.

Concerning restructuring plans, it is established that the debtor may make use of an official model that will be available electronically at the commercial registers. This model will include guidelines on how the restructuring plan is to be prepared, and no notary's involvement or auditor's certificate attesting to the adequacy of majorities will be required.

It provides that restructuring plans for this type of debtor can only be court-sanctioned if requested by the debtor or approved by all shareholders of the debtor company.

Concerning the approval of restructuring plans, it is established that confirmation of the classes of creditors may only be requested by the debtor; and that, even if it has not been approved by all classes of creditors, it may be approved if the classes that have not approved it are treated more favourably than any other lower-ranking class.

3.2. The special regime for micro-enterprises

Micro-enterprises are natural or legal persons carrying out business or professional activity and which: (i) have employed in the previous year on average fewer than ten employees; and (ii) have an annual turnover of less than EUR 700,000 or liabilities of less than EUR 350,000.

There are two possible routes for the processing of these special insolvencies: (i) a *fast-track* liquidation; and (ii) a continuation procedure, characterised by rapid handling and flexibility. Liquidation is compulsory if more than 75% of the liabilities are public loans.

Greater involvement of the debtor and creditors is envisaged. To this end, the Insolvency Reform provides for a system of direct communication between the debtor and its creditors. Thus, the appointment of the insolvency administrator will not always be mandatory. Judicial intervention is also limited. The Commercial Court will only intervene in the event of a dispute between the debtor and the creditors, either over the restructuring or liquidation proposal or concerning the inventory or the classification and quantification of the claims.

In contrast to the ordinary procedure, the special procedure does provide for the submission of a liquidation plan, which may be promoted by the debtor, the creditors or, where appropriate, by the insolvency administration.

Special proceedings are governed, on a supplementary basis, by the provisions of the Insolvency Reform with respect to other insolvencies. However, several procedural features are provided concerning the handling of special procedures, as follows:

(i) Proceedings before the Court shall always and in all cases be conducted electronically;

(ii) Resolutions may be issued orally at the end of any type of hearing or electronic proceedings before the competent Commercial Court, and shall be recorded on audiovisual media, together with a certified copy of the written text;

(iii) The general rule is that no appeal may be lodged against the orders and judgments of the Commercial Court, but a direct appeal for review may be lodged against the decrees of the court clerk;

(iv) In cases where an appeal is allowed, the time limit for the appeal shall start from the time the audio-visual support and the testimony of the resolution are delivered; and

(v) Appeals shall not have suspensive effects unless expressly provided for by the Commercial Court.

Regarding the possible routes available to micro-enterprises that initiate this special procedure, it is striking that they may opt for one or the other from the moment they submit their application.

If they opt for *fast-track*liquidation, the liquidation of the assets will be carried out by the debtor himself. For this purpose, a settlement platform will be available for free and universal access.

On the other hand, the continuation procedure is set up by adapting the rules provided for restructuring plans, but it will be carried out once the special procedure has been initiated (and not previously, as is the case in ordinary procedures).

An abbreviated liability phase is also included in the special procedures, in which the time limits established for the ordinary procedure are reduced. Intervention by creditors is provided for in this phase. Thus, creditors holding more than 10% of the liabilities may submit liability reports, albeit as interveners. Only the insolvency administration or the public creditors may themselves support the liability of the insolvency proceedings. As a new feature, a special *rebuttable* presumption of liability is also included, consisting of inaccuracy in the information or documents provided with the standard forms.

4. Key reform of the second chance regime

This regime is undergoing considerable reform. The most striking of these reforms is the elimination of the assumption that, in order to be discharged from unsatisfied liabilities, it is necessary to satisfy a certain type of debt or that an out-of-court payment agreement has been attempted.

The system established in the Insolvency Reform is based on the premise that any debtor can be discharged from his debts if he satisfies the standard of good faith. All the above, if the exceptions or prohibitions established in the Insolvency Reform do not apply, which include serious circumstances such as having been sentenced by final judgment to imprisonment, even if suspended or substituted, for committing crimes against the socio-economic order, sanctioned for tax offences or having been convicted in the liability phase of the insolvency proceedings.

Similarly, this second chance regime will not be available until (i) two years have elapsed since the final discharge in the framework of the previous application for discharge using a payment plan; or (ii) five years have elapsed since the resolution granting the discharge with the liquidation of assets. This successive application shall not cover public loans.

The debts that fall outside the scope of the discharge are as follows:

(i) certain non-contractual civil liabilities, arising from criminal offences and fines in criminal proceedings and serious administrative penalties;

(ii) maintenance debts;

(iii) debts for salaries for the sixty days before the declaration of insolvency proceedings or accrued thereafter, if not assumed by FOGASA;

(iv) debts for public law claims, except for AEAT debts or Social Security debts, in both cases for a maximum amount of EUR 10,000 (of which EUR 5,000 will be fully dischargeable and the rest at 50% until the maximum ceiling is reached);

(v) debts for legal costs and expenses arising from the discharge;

(vi) secured debts within special privileged claims; and

(vii) in exceptional circumstances, debts that are necessary to avoid the insolvency of the creditor concerned.

The discharge shall mean that the discharged debt cannot be recovered from the debtor. However, it may be claimed from joint and several obligors, guarantors, cosigners, insurers or non-debtor mortgagors, although the action of repetition or return is also affected by the discharge.

The discharge may be revoked within three years after it has been granted: (i) if the debtor has concealed assets, rights or income; (ii) if the debtor's financial situation is improved by inheritance or gambling; or (iii) if a final conviction or administrative resolution disqualifies the debtor from receiving the discharge.

The Insolvency Reform provides for two types of discharge: (i) discharge with payment plan; and (ii) discharge with liquidation.

4.1. Discharge with a payment plan

Discharge with a payment plan means that the debtor is obliged to comply with a payment plan that lasts three years or five years (the latter term applies if the main residence is not realised or when the amount of the payments is variable, depending on the debtor's income). In any case, the payment plan shall take into account the expected income of the debtor and may include assignments in payment or payments in a determinable amount depending on the debtor's income and resources.

In the case of a discharge with a payment plan, claims shall not accrue interest, except for those secured by collateral and up to the value of the collateral.

Concerning the approval of the payment plan, this will be carried out by the Commercial Court, which will grant a period for the creditors to present their arguments. Subsequently, creditors may challenge the discharge with the payment plan; and, if there is a significant alteration of the debtor's situation, the creditors or the debtor himself may request the modification of the payment plan.

In the event that the debtor defaults on the payment plan, the discharge can be revoked if it is established that the debtor has not allocated all his resources (except for the unattachable minimum) to the payment of his debts. In such cases, the Commercial Court may, at its discretion and in view of serious or unforeseeable events, still grant a final discharge.

It may be possible to change the type of discharge from a discharge with payment plan to a discharge with liquidation.

4.2. Discharge with liquidation

The discharge with liquidation applies to insolvency proceedings without assets and to insolvency proceedings in which the insufficiency of assets arises.

In such cases, the application for a discharge with liquidation shall be communicated to the insolvency administration and the creditors in person. Both parties may oppose the application and the opposition will be processed through the insolvency proceedings. Only once this insolvency incident has been resolved may the order for the termination of the insolvency proceedings be issued.

5. The express insolvency

The Insolvency Reform introduces some changes to the express insolvency regime which, in general terms, gives creditors a greater role.

Insolvency without assets (or express insolvency) is defined as insolvency in which (i) there are no assets subject to seizure; (ii) the charges on the insolvency assets exceed their market value; (iii) the cost of realisation of the assets is higher than their market value; or (iv) the value of the assets and rights is lower than the cost of the proceedings.

Express insolvency proceedings, under the Insolvency Reform, would be processed as follows:

(i) It would begin with the filing of the application for insolvency proceedings with the Commercial Court of the debtor's domicile. If the assets of the insolvent entity are insufficient to meet the costs of the insolvency proceedings, the Commercial Court will declare insolvency.

(ii) Once the insolvency has been declared, the decision will be published in the Official State Gazette and the Public Insolvency Register so that creditors representing at least 5% of the liabilities may, within fifteen days, request the appointment of an insolvency administrator.

(iii) If no creditor requests the appointment of an insolvency administrator, the proceedings will be closed; or, in the case of a natural person, the creditor may request the discharge.

(iv) If an insolvency administration is appointed, its fees will be paid by the proposing creditors. The insolvency administration must issue a report within one month. This report shall state whether the conditions for the immediate closure of the proceedings due to lack of assets are met. If the insolvency administration sees signs of a possible clawback action, liable insolvency or directors' liability, it will have a period of two months to exercise the corresponding actions. If the insolvency administration does not exercise these actions, creditors may do so within two months.

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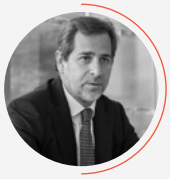

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