Spanish Insolvency Act: the legislation created by the crisis

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The modern Spanish Insolvency Act was passed in 2003. At that time, it created employment and there were no significant concerns about destroying companies. Insolvency scholars conveyed their approval of modernising the Spanish Insolvency Law (SIL) and superseding the law from the 1920s.[1] However, such law had not yet been tested.

Due to the global financial crisis, there have been an increasing number of amendments to the SIL. In 2014, three amendments were passed and two more have already passed in 2015. This article focuses on analysing some of the most problematic issues of the SIL that have been corrected.

Pre-insolvency mechanisms

Pre-insolvency mechanisms were completely unknown in the Spanish legal system until 2009. This does not mean that refinancing agreements did not exist, just that they did not receive specific legal treatment. After 2008, when the crisis started, a concern was detected: banks started to become reluctant to refinance because refinancing agreements could be threatened by the risk of claw-back actions. Thus, the Spanish legislator established several kinds of refinancing agreements which provided some protection against such risk, including: (1) refinancing agreements homologated by the courts; (2) refinancing agreements supported by qualified majorities; and (3) refinancing agreements which complied with certain content requirements.

The amendment carried out by the Royal Decree Law 4/2014 intended to make it easier to reach refinancing agreements. Even though refinancing agreements were granted with protection, this did not always persuade all the creditors to reach an agreement. Dissenting creditors were a menace since they could enforce guarantees, which would then jeopardise the fulfilment of the agreements. This is why the Spanish legislator borrowed the cram-down mechanism from the British legal system. Such mechanism implies that in the event that qualified majorities vote in favour of the refinancing agreement, its effects may also be imposed on dissenting or absent creditors.

The pre-insolvency petition, which may be filed in order to grant additional time for the debtor to renegotiate with its creditors has also been improved. Specifically, the SIL now provides for limitations to enforce *in rem* guarantees during that time (three months as of the filing of the petition plus an additional month to file the insolvency petition if the negotiations are fruitless).

Mechanisms to inform creditors and third parties

The general rule from this perspective used to be the publication in the *Spanish Official Gazette* of the main milestones of the insolvency proceedings (insolvency declaration, beginning of the creditors' arrangement stage or the liquidation phase). The law provided for the existence of the Insolvency Public Registry, but it was not very efficient or set-up correctly. In 2013, a new regulation on the Insolvency Public Registry was passed.

The latest amendments provide for better communication between creditors with the purpose to avoid the courts. In this sense, insolvency administrators now have to provide – via electronic means – relevant documents for the proceedings, including but not limited to: (1) the draft for the provisional report containing the list of assets and liabilities of the company; (2) the provisional report as amended in accordance with the creditors' remarks; (3) the final report as amended after the challenges to the provisional report have been settled; (4) the unfavourable assessments produced by the insolvency administration in connection with proposals for creditors' arrangements; and (5) the quarterly liquidation reports. Also, all challenges filed against the provisional report must be registered with the Insolvency Public Registry.

It is also worth noting that a specific section in the Insolvency Public Registry has been created to register the necessary information of assets to be sold.

Specifically the following information must be included: corporate information on the insolvent company including the sector to which it belongs, where it operates, its business volume, the number of employees, its assets, the contracts entered into with third parties, licences and authorisations, liabilities, any pending lawsuits and labour issues.

These amendments are very positive given that Spanish insolvency proceedings are generally huge proceedings in which hundreds of creditors may intervene. Communicating out of the courts allows creditors to receive information more quickly and frees the court from a significant burden. Also, this transparency allows for an increasing amount of investors interested in purchasing assets or productive units in the framework of insolvency proceedings and thus selling them in better conditions. Until now, sales in the framework of insolvency proceedings were only published in the courts' board and, if the court so accepted, in newspapers.

Mechanisms that ensure the approval of the creditors' arrangements

The legislator became aware of the importance of saving companies and jobs destroyed by the crisis by means of creditors' arrangements. It is important to note that in 2003 the insolvency proceedings were meant to both conserve companies and productive units and to maintain the creditors' satisfaction as much as possible. Today, the latter goal has been given a lower priority.

The first measure to achieve that goal is to reduce the value of the privileged credit rights from the start. Such value must be 90 per cent of the so-called 'reasonable value'. The reasonable value will normally be linked to an updated appraisal of the asset. The legislator tried to avoid a situation whereby a €1m debt endorsed by the mortgage of an asset valued at €100,000 would be 100 per cent privileged. In this case, the privileged credit shall only be €90,000 and the remaining €910,000 shall be ordinary. This does not mean that the creditor may only recover up to €90,000 in a separate enforcement: rather, if the asset is sold for €500,000, the privileged creditor will recover such amount. Only if the proceeds are higher than €1m would the excess be used to pay other creditors.

The possible content to be included in a proposal for creditors' arrangement has been increased, although a maximum deferral of ten years has been established (without the possibility of extension by the judge). Along with haircuts and deferrals, debt capitalisation and other measures may be included. Such measures are not necessarily an alternative to haircuts and deferrals but the drafting of the rule leaves the possibility to join haircuts and/or deferrals with such measures open. Flexibility is key and productive units or assets may be sold although a liquidation of the whole estate of the company is forbidden. Within this framework, assets may be assigned to creditors in order to cancel or decrease their credits.

In our system, the creditors voting on the proposal can be ordinary creditors and privileged creditors who decide to vote in favour. Before the amendment, a quorum required the attendance of at least 50 per cent of ordinary creditors. Now, a quorum may exist even if the attendance of ordinary creditors does not suffice, provided that privileged credit rights which approve the proposal amount to such that the sum of ordinary credit rights and privileged credit rights is equal to or above 50 per cent.

The law currently in force establishes different majorities depending on the content of the proposal. In this sense, proposals entailing an increased sacrifice for the creditors will have to be approved by a qualified majority (65 per cent) and those implying a lesser sacrifice require a simple majority of 50 per cent of the votes.

A recent amendment entails extending the cramming down measures provided by refinancing agreements to proposals for creditors' arrangements. The purpose is similar: avoiding creditors' arrangements are unfeasible due to the vote of only a few minority creditors. The particular measures are that if qualified majorities (60 per cent or 75 per cent, depending on the content of the proposal and the sacrifice requested from the creditors) within the privileged creditors belonging to the same class exist (eg, financial creditors), the proposal may be imposed on those privileged creditors who did not vote in favour of it. The extent arrangements may be imposed on creditors is still controversial. The fact that haircuts and deferrals may be imposed does not raise a doubt, but there is still a discussion on whether or not debt capitalisation or conversion of the debt in bonds or equity loans may be imposed on absent or dissenting creditors. In any case, if this mechanism is applied, privileged creditors risk their ability to enforce their securities in the framework of the creditors' arrangement.

However, these recent amendments do not only intend to foster future proposals, but they also allow already approved proposals (such as those approved under the old regulation) to be renegotiated. This rule is not intended to be permanent. In fact, there is a time limitation to request the renegotiation of the proposal (on or until September 2017 in accordance with the Royal Decree Law 11/2014, or May 2018 in accordance with Law 9/2015). Obviously, the majorities required in order to accept the renegotiation are much higher than those required to approve the proposal in the first place. Specifically, ordinary creditors require a majority of 60–75 per cent depending on the sacrifice required by the creditors, and privileged creditors require a majority of 65–80 per cent of each class of privileged creditor (financial, labour or other creditors) depending on the content of the proposal. As far as privileged creditors are concerned, the majority must be calculated taking into consideration all the privileged creditors as recognised in the final texts, that is, even those privileged creditors who did not vote on the proposal in the first place. However, it is uncertain how these majorities can be calculated considering that some of the debt existing at the time of the approval of the first proposal may (and likely will) have already been paid. Courts should provide a solution to this since at the time a proposal is approved, the insolvency administration is no longer in charge of monitoring payments and there may be uncertainties as to the current status of the outstanding debts.

All these rules intend to invert the trend where nearly 95 per cent of insolvencies end up in the liquidation of the companies, with all the detrimental consequences such as job and productive unit losses.

Mechanisms which ensure that productive units are maintained

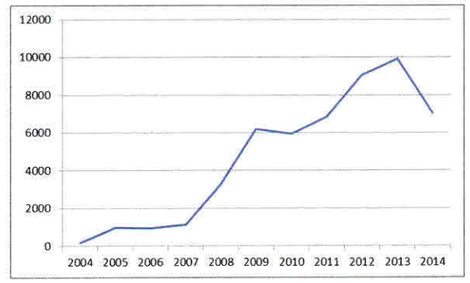
We have already mentioned that the Spanish legislator tries to promote creditors' arrangements but when this is not possible, the legislator intends that the liquidation is completed quickly if there is a risk that the assets lose value. Also, the purpose of the legislator is that liquidation is completed by means of the sale of productive units while maintaining the business and jobs of the productive unit.

The current general rule calls for the assignment of contracts, authorisations and licences unless the purchaser refuses. Another general rule is that the purchaser does not have to satisfy the outstanding debt at the time of purchase (with the possible exceptions of labour and social security debts if there is a succession of companies).

Conclusions and balance of the amendments tested so far

Most of these amendments were passed only a few months ago and it is impossible to judge their true impact. The percentage of insolvent companies ending up in liquidation is still high but the number of insolvency proceedings started decreasing in 2014. This shows that the improvement of the financial situation as well as the success of pre-insolvency mechanisms may be helping to stop the destruction of jobs and companies which was a result of the crisis in Spain.

We have included a chart below with the number of insolvency proceedings opened each year since 2004,[2] showing its negative evolution until 2013 before the decrease in 2014.



Notes

1 Law of 26 July 1922, de Suspensión de pagos.

2 Source: Spanish Statistics Institute ('Instituto Nacional de Estadística'), available at: www.ine.es/dynt3/inebase/index.htm?padre=570&dh=1.