Questions on Spanish Insolvency Law for foreign investors

1. **How long do insolvency proceedings usually last in Spain? What are the major milestones?**

   Insolvency proceedings usually last several years. It is impossible to be more specific given that it will depend on certain circumstances, such as the workload of the court in charge of the proceedings, the number of creditors and the attitude of the creditors (i.e. how assertive they are) and the Insolvency Administrator, who is the person in charge of leading the proceedings and assisting the judge.

   Under Spanish law, insolvency proceedings have three main stages (please note, however, that completion of all of these stages is not compulsory in all cases):

   (i) the common stage, is used to identify the assets and liabilities of the insolvent company;

   (ii) the creditors' arrangement stage is for the debtor, through the acceptance of haircuts, deferrals or other conditions (e.g. debt capitalization) to be able to continue its activity and repay the outstanding debts; and

   (iii) the liquidation stage is the stage in which the company is extinguished and its assets sold (creditors will be repaid the maximum possible amount with the price of the sale).

2. **What is a pre-insolvency request? What are its effects as regards enforcements? Can I find out if a company has filed such a request?**

   Debtors are entitled to file a petition before the court stating that they are carrying out negotiations with their creditors in order to reach a refinancing agreement. Thereafter courts will grant debtors three months to carry out negotiations (an additional month will be granted in the event that a refinancing agreement is not reached and the debtor has to finally file a request for insolvency). During this period the courts will not declare the company insolvent, even if the creditors file a request for involuntary insolvency. In general terms, enforcement proceedings cannot be filed during this time and those already initiated shall be stayed unless the enforcement proceedings have been filed regarding assets that are not considered necessary for the activity of the company. The debtor will be given the opportunity to declare the assets that it deems necessary in order to continue its activity. In the event that this cannot be agreed upon, the Commercial Court where the pre-insolvency communication was filed will decide the nature of the assets.

Enforcement proceedings may be filed again once the refinancing agreements have been executed, once the court homologation of a refinancing agreement has been acknowledged by the court or once an out-of-court payment agreement has been reached.

Until 2014, it was not compulsory to publish when a debtor had filed a pre-insolvency request; however, currently, the general rule is that pre-insolvency requests must be published. Furthermore, they will only remain confidential if the debtor so requests it.

3. Who can request insolvency proceedings?

The debtor, the creditors, an insolvency mediator or any shareholder or member of the company that is personally liable for the debtor's debts can request insolvency proceedings. Assignors of credit rights assigned within the six months prior to the request may not file a request.

The petition filed by the creditors must demonstrate that any of the legally established circumstances proving the insolvency situation have indeed occurred. The most common circumstance cited is that the debtor is unable to fulfil its current obligations on a general basis.

4. Who acts as the insolvency administrator? What do they do?

The insolvency administrator is a lawyer or economist chosen from a list of professionals. The insolvency administrator is appointed by the court. In general, in the event that the insolvency is voluntary, the directors of the company continue to manage the company and the insolvency administrator merely authorises their decisions; conversely, in the event that the insolvency is not voluntary, the insolvency administrator will replace the ordinary directors.

Their fees are assessed on the basis of the value of the company's assets and liabilities and are considered mass credits.

5. How are credit rights ranked under the SIA (Spanish Insolvency Act)? Under what circumstances can a credit right be ranked as a privileged credit right?

There are two kinds of credit rights:

A. Claims against the insolvency estate, which are paid with the assets of the company as soon as they are due. These claims are generally debts that arise after the insolvency is declared or are the expenses of the insolvency proceedings.

B. Insolvency credit rights, which are subject to the ranking and regime established by Insolvency Law and will generally be paid within the framework of a creditors' arrangement or liquidation. The latter may be ranked as follows:

a. Privileged credit rights: these are classified as public, labour, financial and other credit rights. There are two kinds of privileged credit rights:

   (i) Special privilege: these are secured credit rights endorsed by *in rem guarantees* (such as mortgages and pledges). The credit right will only be deemed as privileged up to the value of the guarantee as appraised by an expert. The creditors may enforce the guarantee under certain conditions during the insolvency proceedings. The asset endorsing the credit right will be used to repay these creditors.

   (ii) General privilege: these are, up to a certain extent, labour credit rights, public credit rights and 50% of the fresh money obtained through refinancing agreements. Once mass creditors have been repaid, these credit rights will be the first to be paid-off.

b. Ordinary credit rights: this is a residual category to which all the credits not included in the other categories belong. They are only paid once the general privileged credit rights have been paid off.

c. Subordinated credit: this category includes interest, fines, credit rights held by persons especially related to the insolvent company ("*personas especialmente relacionadas*"), and credit rights that are not credit rights communicated in a timely manner (under certain circumstances). These credit rights are only paid once the general privileged and ordinary credit rights have been covered.

6. What advantages allow for a credit right to be ranked as a special privileged credit right instead of an ordinary credit right?

Special privileged credit rights are paid with the monies obtained from the sale of the asset securing the credit right. If the value of the asset exceeds the amount of the privileged credit right, the remainder will be used to pay off the other creditors. If the value of the asset does not cover the amount of the privileged credit right, the portion not covered shall be considered as an ordinary credit right. Furthermore, privileged creditors are entitled to file enforcements while the insolvency is ongoing (with some restrictions if the asset is necessary for the debtor's activity). This right may even be maintained within the framework of a creditor's arrangement in the event that: (i) such creditors do not specifically accept the proposal; and, (ii) they are not crammed down as mentioned in question 12.

7. Is it possible for creditors to file enforcement proceedings during the insolvency proceedings?

Ordinary enforcements are no longer possible. However, it is possible to file enforcement proceedings regarding assets that are *in rem guarantees* (such as mortgages or pledges). If the Commercial Court declares that the asset is not necessary for the debtor's activity, enforcements may take place without restrictions. Conversely, if the Commercial Court

declares that the asset is necessary, the creditor must wait before filing enforcement proceedings: (i) that a creditors' arrangement not affecting such right has been approved; or (ii) that a year from the insolvency declaration has elapsed if the winding-up stage has not yet begun.

8. What can I do if I believe my credit right has not been properly ranked? What are the costs of filing a challenge?

Once the creditors have filed their proofs of claim, the insolvency administration prepares a provisional report containing a list of the company's assets and liabilities. The creditors are entitled to file a challenge within 10 working days if they disagree with the report. In general terms, courts do not usually order the losing party to bear the costs of the proceedings.

9. Under what circumstances can a creditor file a creditors' arrangement proposal?

Creditors may file an arrangement proposal as long as (i) they hold claims representing more than 20% of the debtor's total liabilities; and (ii) the debtor has not requested their own winding up.

In very specific cases (i.e. when the debtor is a concessionaire of public works, or services or contractors of the public administration) the public administration, as well as the entities and companies linked to it, is entitled to file a proposal for a creditors' arrangement even if it is not a creditor or does not reach the 20% threshold. This rule has mainly been established to provide a solution to the insolvency situation of several toll roads.

10. What kind of content is included in a creditors' arrangement proposal?

Creditors' arrangement proposals are only admissible if they contain haircuts, (without limitation; although it is clear that haircuts of 100% cannot be accepted) and/or deferrals (of up to 10 years). In addition, as an alternative or additional proposal (for all or some of the creditors), other content may be included such us the conversion of debt into shares, quotas, convertible bonds, equity loans, etc. It is also possible to establish a proposal for the sale of the whole company or any of its productive units and the transfer of assets partially or totally covering the outstanding debt.

Proposals may not be subject to any conditions. They must include a viability plan and a payment plan.

It is not possible to include the liquidation of the company in the proposal.

11. Who is entitled to vote for a creditors' arrangement proposal?

All creditors may vote for a creditors' arrangement proposal except for subordinated creditors (in addition, creditors who purchased credit during the insolvency proceedings are also entitled to vote for a creditors' arrangement proposal). Creditors with special privileged credit rights can decide whether to vote in favour of the arrangement or not to vote (in the latter case, they will not be bound by the arrangement and will hence maintain their right to separately enforce the assets granted as a guarantee of their credit rights).

Previously, creditors with credit rights acquired from other creditors were not allowed to vote for the creditors' arrangement unless this right was purchased by companies subject to financial supervision. However, the current SIA imposes no restrictions on these kinds of creditors. The legislator should not suspect that the mere existence of a market of distressed debt implies any kind of fraud unless otherwise evidenced.

12. What percentage of the vote is required to pass a creditors' arrangement?

Firstly a quorum of 50% of creditors representing ordinary credit rights is required. However, for this purpose, privileged creditors accepting the arrangement will be deemed to be ordinary creditors. This allows privileged creditors to have a more significant role in the creditors' arrangement stage.

In accordance with article 124 of the SIA, in order to pass a creditors' arrangement the following majorities will be required:

- Value of the credit rights voting in favour must be higher than the value of the credit rights rejecting the proposal (simple majority): this is required if the proposal includes haircuts of up to 20% without deferrals or deferrals of up to 3 years without haircuts.

- 50% of the ordinary credit rights: this is required if the arrangement includes (i) haircuts equal to or lower than 50% and deferrals equal to or lower than 5 years; or (ii) debt conversion into equity loans with a duration of up to 5 years.

- 65% of the ordinary credit rights: these results are required if the proposal includes any of the following three options: (i) haircuts higher than 50% and delays of up to 10 years; (ii) debt conversion into equity loans with a duration up to 5 years; and (iii) debt conversion into shares or convertible bonds.

It is important to note that the current version of the SIA establishes that, for these purposes, secured creditors voting in favour of the creditors' arrangement must be taken into account.

Nevertheless, additional majorities will be required to extend the effects of the creditors' arrangement to secured creditors who did not vote in favour of the arrangement.

13. Who ensures that the creditors' arrangement is fulfilled?

It is common for the arrangement itself to establish a specific body (such as a monitoring commission) to ensure that the arrangement is being fulfilled. The insolvency administrators will no longer be in charge of the company and the corporate directors will regain their responsibilities in the company.

14. What action can creditors take if the debtor does not comply with the creditors' arrangement?

The creditors may file a claim evidencing that the arrangement has been breached. This will suffice for creditors bound by the creditors' arrangement.

If creditors not bound by the creditors' arrangement are unable to recover their debts, they must prove that the company is unable to fulfil its regular payment obligations or that it has failed to comply with its payment obligations to its employees, the Tax Authorities or Social Security in the last 3 months. The debtor may oppose the claim, however, if it is successful, the court will begin the liquidation stage.

In any case, secured creditors are entitled to initiate or resume separate enforcement proceedings for their securities, provided that they are not bound by the creditors' arrangement.

15. Can a creditors' arrangement be renegotiated if it is breached by the debtor?

In the event that a creditors' arrangement approved under the former regime is breached on or before 27 May 2017, the debtor or creditors representing 30% of the total liabilities may request an amendment of the creditors' arrangement. The proposal for amendment shall be voted on by the creditors and will be passed if: (i) 60% or 75% of the ordinary creditors support the proposal (depending on the content of the amendment); and (ii) 65% or 80% of each type of privileged creditors support the proposal (depending on the content of the amendment). If the proposal is approved by the creditors, the amendment must still be approved by the court.

16. Under what circumstances is it possible to purchase assets involved in insolvency proceedings?

It is possible to buy assets during the common stage of insolvency proceedings, provided that the court authorises the transaction although it will depend on other issues such as whether the assets are necessary or not for the insolvent company to continue with its activity). It is also possible to be awarded assets during the enforcement proceedings of *in rem guarantees*, provided that the asset is not necessary or a year has elapsed since the declaration of insolvency.

Within the framework of a creditors' arrangement it is possible to include the sale of the company or productive units. It is also possible to award assets in payment of the debt.

Finally, within the framework of the winding-up of the company, it is usual for assets to be awarded in payment of the debt (provided that the creditor agrees to such a solution), a public bid or by means of a direct sale. The sale of the whole company or of productive units is preferred over the sale of specific assets.

In any one of these scenarios, the contracts, authorisations and licences of the company or productive unit will be assigned to the purchaser unless it expressly objects to it. In general terms, the purchaser will receive the productive unit free of debts, although it may have to

assume the labour and Social Security debts if it is understood that the productive unit maintains said debts.

17. Under what circumstances is it possible to convert debt into equity?

As previously mentioned, it is possible to include the conversion of debt into equity within the creditors' arrangement as an alternative for the creditors.

In the pre-insolvency stage, the conversion of debt into equity (or equity loans) is also possible under the framework of refinancing agreements. Refinancing agreements of this kind may in fact, among other measures, specifically include such conversion provisions. It is important to point out that refinancing agreements including these conversion measures may be imposed upon financial creditors, provided that qualified majorities are reached (60% for the conversion of debt into equity loans for less than 5 years and 75% for the conversion of debt into equity or subordinated loans for a term between 5 and 10 years).

In any case, the conversion will entail a share capital increase that must be passed by a majority of the votes of the shareholders present in the meeting. The shareholders that refuse to carry out the capitalisation without reasonable grounds as provided for in the framework of refinancing agreements may be affected by the liability stage, which may be opened in the insolvency proceedings.

18. Is it possible to enforce assets during an ongoing creditors' arrangement?

Creditors with special credit rights may decide to vote in favour of the creditors' arrangement. If this is the case, they will be bound by the content of the creditors' arrangement. If they decide not to vote, they will maintain the right to separately enforce the assets which guarantee the credit rights.

However, it is important to note that if the secured creditors vote in favour of the creditors' arrangement with a majority of more than 60% (if the arrangement includes haircuts lower than 50% and deferrals lower than 5 years) or 75% (if the arrangement includes haircuts higher than 50% and deferrals of 5 to 10 years), creditors of the same class (e.g. if the creditor is a bank then these would be other banks) will be bound by the arrangement even if they did not vote in its favour. The previously mentioned majorities will be calculated by taking into account the total value of the guarantees granted within the same class.

19. How are the assets of an insolvent company sold in the winding-up of the company?

The assets will be sold in accordance with the liquidation plan produced by the Insolvency Administration and approved by the court. In any case, under Spanish law it is usually preferable to sell all the assets and productive units of the company as a whole. If this is not possible, the second best option is to sell independent productive units. If this is not possible, the assets will be sold separately (the usual means of sale are by public bid, direct sale, or the transfer of assets for decreasing or cancelling the debt).

20. How will the assets that secure privileged credit rights be treated under the framework of the sale of productive units?

Such assets may be sold with or without liens.

If the lien is removed, the privileged creditors will obtain an amount corresponding to the percentage of the value of the asset divided by the total value of the company or the productive unit sold. That is, if the value of the asset is 10% of the value of the company/productive unit, the creditor must receive 10% of the price of the sale of the company / productive unit.

If this amount does not cover the value of the guarantee, creditors of the same class that represent 75% of their credit rights must consent to the sale. If the value of the guarantee is covered, no consent from the creditors is required.

If the lien is not removed, the purchaser will take over the seller's obligation and no consent from the creditors will be required.

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