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LEGAL FLASH | COMMERCIAL AND LITIGATION PRACTICE AREAS

NEW REFORM OF THE INSOLVENCY ACT

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Royal Decree-Law 11/2014, of September 5, on urgent measures in insolvency issues, introduces significant reforms into the Insolvency Act in matters of composition agreements and insolvency liquidation to facilitate the continuity of financially viable undertakings. Among other amendments, it extends to the composition agreement several rules of refinancing agreements, establishes the possibility of extending specific effects of the composition agreement to privileged creditors (including public law entities) and introduces measures to facilitate the transfer of production units of the insolvent company, including rules for labour and social security issues.

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INTRODUCTION

Royal Decree-Law 11/2014, of September 5, on urgent measures in insolvency matters ("**RDL 11/2014**"), amends the Insolvency Act ("**IA**") in matters of composition agreement and insolvency liquidation to facilitate the continuity of financially viable companies.

RDL 11/2014 came into force on the day following its publication in the Official Gazette of the Spanish State (September 7, 2014), although according to its transitional provisions, it will be applicable to proceedings that have already begun.[1]

The senate is carrying out the parliamentary processing of the draft bill adopting urgent measures in matters of refinancing and restructuring corporate debt (deriving from Royal Decree-Law 4/2014, of March 7, which amended substantial aspects of the regulating of the pre-insolvency institutions and alternatives to insolvency). We believe this draft bill will be approved in the coming weeks and will probably introduce some additional amendments into the IA in matters of pre-insolvency institutions, as well as a new regulation of the system of the insolvency administration, on which we will duly inform.

AMENDMENTS IN RELATION TO THE COMPOSITION AGREEMENT

To bring the system of a creditors' composition agreement closer to that foreseen for the approval of refinancing agreements in Additional Provision 4 IA, RDL 11/2014 deals with the matters below.[2]

SPECIAL PRIVILEGE AND VALUATION OF GUARANTEES

RDL 11/2014 mainly contemplates from a financial perspective claims with a special privilege under article 90 IA, and limits the scope of this privilege to the part of the claim not exceeding the value of the respective guarantee. The part of the claim exceeding this amount will be classified according to its nature.

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[1] In general, amendments will apply if there is no report from the insolvency administration at the date of the entry into force. When the report has been issued, if the composition proposal has not been voted, rules will apply regarding the calculation of majorities for agreements with syndication clauses, the categorisation of the insolvency, and measures facilitating the transfer of production units applicable to sales during the common phase and sales in liquidation. Insolvency proceedings of public works and services concession-holders have special transitional provisions.

[2] These measures may be included in composition agreements approved according to the legislation repealed by RDL 11/2014 if they are not fulfilled in the two years following the entry into force of RDL 11/2014, provided that some adhesion percentages of creditors to the composition amendment proposal are reached. For these purposes, creditors representing at least 30% of the total liabilities can submit an amendment proposal. Amendments will be approved when percentages of liabilities greater than those generally required are met (depending on the content of the agreement, 60% and 75% for ordinary creditors, and 65% and 80% for privileged creditors, within each class).

The value of the *in rem* guarantee will be that resulting from deducting from nine-tenths of the fair value[3] of the asset or right over which the guarantee lies, any outstanding debts enjoying a preferential guarantee over the same asset. The value cannot be less than zero or greater than the value of the privileged claim or the value of the maximum mortgage or pledge liability which might have been agreed.[4]

VOTING RIGHT

Another relevant amendment in matters of composition agreements is attributing the voting right in the meeting to creditors that until now did not hold this right. The new wording of article 122 only excludes subordinate claims from the vote, thus providing the option to vote at the meeting to creditors that might have acquired their claims after declaring insolvency, even when these are not financial institutions subject to supervision, or acquisitions carried out under universal title as a result of an enforcement, as the precept formerly required. This amendment aims to foster a market of these claims, helping creditors obtain liquidity in a situation of debtor insolvency without waiting for liquidation.

PERSONS ESPECIALLY RELATED TO THE INSOLVENT COMPANY ("PER")

To avoid fraudulent actions occurring as a result of the extension of the group of creditors with voting rights, article 93 IA is also amended and the concept of PER extended significantly, deprived of voting under article 122.1.1º IA.

RDL 11/2014 clarifies that creditors of the insolvent legal entity company will be PERs if, when the debt is created, they are indirect holders (a significant new aspect[5]) of 10% of its share capital or 5% if the company has securities admitted to trading on an official secondary market.

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[3] Fair value refers to: (i) for listed securities, the average weighted price at which they would have been traded on one or more regulated markets in the last quarter before the date of the declaration of insolvency, according to the certificate issued by the company governing the market in question; (ii) for real estate assets, that resulting from the appraisal report issued by an officially approved entity; and (iii) for other assets, that resulting from the report issued by an independent expert in accordance with the valuation principles and rules generally recognised for these assets. The reports established for the latter two cases will not be necessary when the value has been determined by an independent expert within six months before the date of the declaration of insolvency, or when the assets are cash, current credit accounts, electronic money or fixed-term deposits.

[4] If the guarantee in favour of a creditor affects several assets, the joint value of the guarantees must not exceed the value of the corresponding creditor's claim.

In the case of a guarantee constituted *pro indiviso* in favour of two or more creditors, the value of the guarantee corresponding to each creditor will result from applying to the total value of the special privilege the proportion corresponding to each of them, according to the *pro indiviso* rules.

[5] To date, the IA had not made any statement regarding indirect participation. Most doctrine and some case law decisions had defended a restrictive interpretation of the rule, bearing in mind restrictions on the nature of rights (see rulings of the Barcelona Court of Appeal (Section 15) of November 28, 2008 and October 5, 2010). However, several doctrinal positions and some examples of case law had considered companies holding an indirect stake in the insolvent company to be PERs (see, for example, ruling of the Valencia Court of Appeal (Section 9) of February 21, 2013.

In the case of an insolvent company, also included as PERs are the PERs of individuals shareholders (*inter alia*, their spouses or direct relatives, including siblings, and any legal entities these control or manage).

CONTENT OF THE COMPOSITION AGREEMENT AND MAJORITIES

The content of the composition agreement and the system of majorities for its approval are subject to a significant reform influenced by the system for approving refinancing agreements. One new aspect is that the proposed composition agreement is allowed to contemplate, *inter alia*, the following measures: (i) debt relief and grace periods above the limits established to date by the IA, when agreed by a specific percentage of affected liabilities;[6] (ii) transformation into financial instruments of a ranking, maturity or characteristics different to the original debt, when the majorities stated later are obtained, and (iii) assignment in payment of assets and rights not necessary for the continuance of the professional and business activity, under specific conditions.[7]

Thus, the system of majorities is as follows:

(a) The majority required for the approval of the composition agreement will depend on the content of what is agreed. The majority (previously general) of 50% of the ordinary liabilities of the debtor will be required when the composition agreement establishes (i) debt relief equal to or less than 50% of the amount of the claim, (ii) a grace period not exceeding five years, or (iii) except public and labour creditors, the conversion of the debt into participating loans during the same maximum period.

(b) The simple majority is maintained (liabilities in favour greater than liabilities against) regarding proposals consisting of a grace period, for ordinary claims, of no more than three years, or debt relief not greater than 20% of the amount of the claim.

(c) The vote in favour will be required of 65% of the ordinary liabilities if the proposal contemplates (i) debt relief greater than 50% of the claim, a grace period for a period of five to ten years, the conversion of the debt into participating loans during that same period, or (ii) except public and labour creditors, the conversion of the claim into shares or corporate interests of the debtor company,[8] the transformation of the debt into financial instruments of a rank, maturity or characteristics different to the original debt,[9] or assignments in payment.

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[6] However, the judicial authority can no longer authorise a composition agreement that includes provisions or measures different from those established in the IA.

[7] The value of the asset or right must be equal to or lower than the claim extinguished. Otherwise, the difference should be reimbursed to the insolvency estate. Assignment in payment cannot be imposed on public creditors.

[8] The capital increase resolution will be adopted by the ordinary majority established under articles 198 and 201.1 of the Companies Act and it will be understood that the liabilities are due and demandable.

[9] Convertible bonds, subordinate loans and loans with interest subject to capitalisation are mentioned.

In any case, if the agreements are subject to a syndication clause after the insolvency declaration, it will be understood that the creditors vote in favour of the composition agreement to all effects (calculation of majorities and extension to dissenters) when those representing at least 75% of the liabilities affected by the agreement, or any lower percentage agreed in the syndication rules, vote in favour.

EFFECTS OF THE COMPOSITION AGREEMENT. EXTENSION TO PRIVILEGED CREDITORS

The most relevant new aspect in matters of composition agreements is the possibility of extending certain effects established in the agreement to creditors with a general or special privilege, including the part covered by the value of the guarantee. For this, it will be necessary for the composition agreement to be adopted by creditors of the same class. RDL 11/2014 distinguishes between public law creditors, labour law creditors (excluding senior management staff whose sum exceeds the amount with general privilege, provided under article 91.1 IA), financial creditors (holders of any financial indebtedness regardless of whether they are subject to financial supervision) and the rest (mainly commercial creditors) with the vote in favour of the following reinforced majorities for each class affected:[10] (i) 60%, in the case of the measures established under letter (a) of the previous section; and (ii) 75%, in the case of the measures established under letter (c) of the previous section.

AMENDMENTS IN RELATION TO THE LIQUIDATION

As regards insolvency liquidation, measures are introduced for facilitating the transfer of the business or production units of the insolvent company.[11] We emphasise the following measures:

1. The acquirer takes over the production unit in contracts[12] and in any administrative authorisations or licenses the insolvent company holds, unless the acquirer states

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[10] Reference to classes must be understood in accordance with article 94 IA. To calculate the majorities mentioned, depending on the type of privilege enjoyed by the creditor affected, the rule differentiates:

(i) Creditors with special privilege: the calculation is made depending on the proportion of the accepting guarantees in respect of the total value of the guarantees granted within each class.

(ii) Creditors with general privilege: the calculation is made depending on the accepting liabilities in respect of the total liabilities benefiting from a general privilege within each class.

[11] It is established that the special aspects in the transfer of the production units of the insolvent company in the liquidation stage in new article 146 *bis* IA will also be applicable in the event of a sale in the common phase (as interpreted by insolvency case law) and in the case of proposals included in the insolvency composition agreement.

[12] The acquirer automatically taking over the contracts forming part of the production unit transferred had not generally been admitted by the courts, except in occasional pronouncements (ruling of Madrid Commercial Court no. 8, of December 20, 2013).

its intention not to do so. As regards employment contracts, article 44 of the Workers Statute (regulating employer succession) applies.[13]

2. Exemption of liability of the acquirer for those claims (insolvency claims or claims against the estate) not met by the insolvent company before the transfer, unless the acquirer assumes them, any legal provision exists to the contrary or the acquirer of the production unit is a person especially related to the insolvent company. According to the new drafting of article 149.2 IA, the acquirer will assume the insolvent company's debts with the social security.[14]

3. Possibility of the liquidation plan establishing, under certain conditions, except in the case of public creditors, the assignment of assets or rights in payment or for payment of the insolvency claims.

4. To facilitate the liquidation, the insolvency judge may resolve to withhold 10% of the overall assets used for meeting future oppositions.

5. The following specific rules are established for assets and rights affected by claims with special privilege included in the production unit transferred:

   (a) If they are transferred without the subsistence of the guarantee, the proportional part of the price obtained equivalent to the value that the asset or right involves in respect of the overall value of the production unit will correspond to the privileged creditors. The consent of the privileged creditor is not required if the price received is equal to or higher than the value of the guarantee. Otherwise, 75% of the privileged creditors with right of separate enforcement affected by the transfer and belonging to the same class according to article 94 IA must state their agreement (the part of the guarantee not paid will be classified according to its nature).

   (b) If they are transferred with the subsistence of the guarantee, with the acquirer replacing the production unit in the obligation of the insolvent company, the consent of the creditor is not required and the claim will be excluded from the overall liabilities of the insolvency.

6. Detailed regulation of the content of the purchase offer of the production unit (in the case of auctions and in direct disposal), including, *inter alia*, information on the

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[13] Labour and commercial courts have taken opposing positions regarding the new employers' assumption of labour obligations. According to some courts, the acquisition of business units within the framework of an insolvency procedure is not a case of employer succession. However, other courts have imposed the obligation on the new employer to assume the previous employer's position and continue the employment contracts. Under the new rules, it seems that there will be employer succession even when business units are acquired in the liquidation phase. However, under article 149.2 IA, the court can order acquirers not to assume any part of the amount of the salaries and compensations pending payment before disposal that are covered by the Salary Guarantee Fund under article 33 of the Workers Statute.

[14] The IA follows the interpretation of the General Social Security Treasury, which is different to the interpretation of most commercial courts.

economic solvency of the bidder and the human and technical resources available, specific designation of assets, rights and contracts and licenses included in the bid, difference in the price offered with or without the subsistence of guarantees and effect of the bid on the workers.

AMENDMENTS IN RELATION TO THE CATEGORISATION OF THE INSOLVENCY

Article 167 IA has been amended to clarify that the expression "classes" also refers to classes of creditors defined in new article 94 IA (i.e., public, labour, financial and others). Therefore, the section to categorise the insolvency will not be pertinent when judicial approval of a composition agreement is granted whereby a debt relief lower than a third of the amount of the credits or a grace period not exceeding three years is established for all creditors or for one or several classes, including those defined in article 94 IA.

OTHER AMENDMENTS

PUBLIC WORKS AND SERVICES CONCESSION-HOLDERS

A special system is established for insolvency proceedings of concession-holder companies for public works and services or public authority contractors (applicable particularly to highway concession-holder companies). It may be agreed the joinder of insolvency proceedings that have already begun when a proposed composition agreement affects all of them, which may be presented by the public authorities –or by their subsidiary entities or companies-, and the approval of the proposal may be subject to the approval of those presented in the remaining joindered proceedings. The competent court to hear the accumulated proceedings will be the court hearing the insolvency of the debtor with the greatest liability at the time insolvency is requested.

For insolvency proceedings where the liquidation phase has not been opened yet, the rule regarding the extension of the insolvency composition agreement to the privileged creditors will apply (as explained in the previous section regarding the amendments in relation to the composition agreement).

Also, new deadlines to present a composition agreement are granted if the liquidation phase has not been opened yet.

ROYAL DECREE-LAW 5/2005

The first additional provision clarifies that actions deriving from the application of article 5 *bis* IA (communication of the beginning of negotiations to reach a refinancing agreement, an early composition agreement or an out-of-court payment agreement) and of Additional Provision 4 IA (court-sanctioned refinancing agreements) will be considered as remedying measures for the effects of Royal Decree-Law 5/2005. As a result, any financial guarantee agreements constituted under this rule must not be limited, restricted or affected by such actions, and can be enforced separately under Royal Decree-Law 5/2005.

CIVIL PROCEDURE ACT

Article 695.4 of the Civil Procedure Act is also subject to reform to adapt its content to the Judgment of the Court of Justice of the European Union dated July 17, 2014. The new wording allows the mortgage debtor to submit a remedy of appeal against any ruling dismissing its opposition to foreclosure based on the abusive nature of a contractual clause constituting the basis of the foreclosure or that might have determined the amount due.

COMPANIES ACT

The provisions of article 348 *bis* of the Companies Act regulating the exit right of members or shareholders in the event of failure to distribute dividends will not be applicable until December 31, 2016.