International Corporate Rescue

Published by

Chase Cambria Company (Publishing) Ltd

www.chasecambria.com

Centre for Commercial Law

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

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ARTICLE

The Spanish Insolvency Reform: A Focus on the New Pre-Insolvency System

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Synopsis

On 26 September 2022, Act 16/2022 of 5 September amending the Spanish Recast Insolvency Act[1] ('Act 16/2022') entered into force, more than three years after the EU Restructuring Directive[2] was enacted. Act 16/2022 transposes the EU Restructuring Directive into Spanish law and aims to address the existing constraints of the current Spanish insolvency system through a major structural reform of, among others, the pre-insolvency regime. The new pre-insolvency system introduced by Act 16/2022 enables recourse to pre-insolvency tools at an earlier stage of financial difficulties and provides a more flexible legal framework that can be tailored to the circumstances of each case. This should enable early and rapid restructurings to be achieved, in turn allowing debtors to continue in business and ultimately avoid – or overcome – insolvency. This new system, whose cornerstone is the restructuring plan, will drastically transform restructuring deals in Spain and change negotiation dynamics, giving a leading role to creditors and leaving shareholders holding equity that has no value with virtually no leverage unless they are willing to recapitalise.

The new restructuring plans

Act 16/2022 has introduced the so-called restructuring plans,[3] replacing the former refinancing agreements. Restructuring plans are available where there is a 'likelihood of insolvency', defined as a situation where it is objectively foreseeable that, in the absence of a restructuring plan, the debtor will not be able to meet its obligations falling due within the next two years. Until now, only debtors in a situation of current or imminent insolvency (i.e., foreseeable inability to meet obligations falling due in the next three months) could resort to pre-insolvency proceedings. Therefore, the availability of these tools at an earlier stage of financial difficulties is the first of the new features introduced by Act 16/2022 to foster preventive restructuring. In any case, the use of pre-insolvency tools is not excluded when the debtor is in a situation of imminent or even current insolvency (provided that insolvency proceedings have been not admitted for processing). The pre-insolvency system maintains this flexibility based on the principle that a restructuring is justified as long as the debtor is economically viable.

Debtors in a situation of likelihood of insolvency, imminent insolvency or current insolvency can either communicate to the court that there are negotiations taking place with their creditors to agree on a restructuring plan (in practice referred to as 'filing for pre-insolvency proceedings') or directly request the court to sanction an approved restructuring plan. The ultimate purpose of this pre-insolvency communication, which was already available under the previous regime, is to enable the debtor to benefit from a three-month stay of individual enforcement actions – judicial or out-of-court – in respect of assets necessary for the continuation of its business activity to support the negotiations of a restructuring plan. One of the new features introduced by Act 16/2022 is the possibility of extending the stay for a further three months if certain conditions are met. Insolvency applications from creditors are not admitted for processing for the duration of the effects of the pre-insolvency proceedings. After the three months (or any extension), if the negotiations have failed and the debtor is in a situation of current insolvency, the debtor has one month to apply for insolvency proceedings.

Notes

1 Royal Legislative Decree 1/2020 of 5 May approving the recast text of the Insolvency Act (*Real Decreto Legislativo 1/2020, de 5 de mayo, por el que se aprueba el texto refundido de la Ley Concursal*).

2 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 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, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

3 The term 'plan', rather than 'agreement', is also used by the EU Restructuring Directive and reflects the possibility of imposing the restructuring plan on dissenting creditors and, under certain conditions, even on the debtor's shareholders, as further discussed below.

Restructuring plans as such are broadly defined and can provide for changes in the composition, conditions or structure of the debtor's assets and liabilities or any other part of its capital structure, including through the sale of assets or parts of the business or the business as a whole, as well as operational changes. Another key feature of the new restructuring plans is that not only financial claims, but all types of creditors and claims, with very few exceptions, can be affected (and eventually crammed down), including commercial creditors, contingent claims and claims subject to conditions, and public law claims (the latter subject to conditions and restrictions as to the effects that can be imposed). In addition, and although labour claims are specifically excluded, senior management contracts can also be terminated if the success of the restructuring so requires and any indemnity arising in favour of the manager as a consequence of such termination will be considered a claim that may be affected by the plan.

Approval of restructuring plans. Class formation and possibility of cram-down/cram-up

The new pre-insolvency system maintains the existing principle of majority decision by creditors and minimum judicial intervention. Thus, Act 16/2022 leaves it to the parties concerned to reach an agreement on the restructuring plan. Minimum procedural safeguards are established to ensure a correct configuration of affected creditors' classes, a qualified majority in favour within each of these classes and the respect for a minimum economic value when there are dissenting creditors or classes of creditors.

All creditors whose claims are affected by the restructuring plan are entitled to vote on the plan and must vote in separate classes. Voting rights are determined on the basis of the nominal amount of creditors' claims and not on the basis of numerosity. As for the criteria for class formation, they are relatively open, provided that classes are to be formed on the basis of a joint interest of creditors belonging to the same class, determined according to objective criteria. This joint interest is primarily determined on the basis of insolvency rating, but not solely. It is possible to separate claims with the same insolvency rating into different classes where there are different joint interests within the same rating, for example, different nature of the claims (e.g., financial/non-financial) or due to the existence of a certain conflict of interests (e.g., *pari passu* creditors some of which own as a well an equity stake). Claims benefiting from a security interest should form, in principle, a unique and single class, unless separate classes are justified due to the diversity of the secured assets or due to any other criteria justifying class separation (e.g., existence of a conflict of interest). Further, public law claims should form a separate class within their respective insolvency rating.

Adequate class formation will normally be scrutinised in the *homologación* phase (inadequate class formation being a ground for challenge). However, Act 16/2022 allows interested parties to seek judicial confirmation of the adequacy of class formation at an earlier stage. Classes thus confirmed exhaust the possibility of a challenge on these grounds at a later stage, and we anticipate this to be a useful tool when there is a disparity of criteria on class formation during the negotiation of the plan.

For the plan to be approved by each class of creditors (intra-class cram-down), a favourable majority of more than two-thirds of the relevant claims is required. This majority is increased to 75% for classes of secured creditors. In the case of claims subject to syndication agreements, contractual arrangements on procedure and voting will be respected, and the agreed contractual majorities will also apply if they are lower than the above. For dissenting classes of creditors to be crammed down or crammed up (cross-class cram-down/cram-up), the restructuring plan must have been approved by a simple majority of the classes, provided that at least one is a class with a privileged insolvency rating. Failing that, entire classes of creditors can still be crammed down or crammed up if the plan has been approved by at least one creditor class that is considered to be 'in the money' (i.e., that would have received some payment, by applying the insolvency ratings provided for in the law, considering the value of the debtor as a going concern). Determining the value of the debtor will therefore be key when 'in-the-money' creditors seek to impose a restructuring plan and Act 16/2022 determines that such valuation must be issued by a Restructuring Expert appointed by the court (upon proposal of either the debtor or creditors representing more than 50% of the claims affected by the plan).

Shareholders: a paradigm shift

Restructuring plans must be submitted for shareholder approval when they contain measures that require such approval under Spanish corporate law (e.g., a capital increase, mergers, spin-offs, or the disposal of essential assets). For the purposes of expressing shareholder consent (where appropriate), general corporate rules apply, but Act 2016/2022 has introduced certain special rules to streamline the process and facilitate the achievement of a resolution favourable to the plan. Nevertheless, one of the main new features introduced by Act 16/2022 is the possibility to impose a restructuring plan against the will of the debtor's shareholders (equity cram-down), provided that the debtor is in a situation of current or imminent insolvency. Under the previous regime, only restructurings consented by

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shareholders were possible, as the ability to cram down existed only with regards to dissenting creditors. In this way, the Spanish legislator has transposed the mandate of the EU Restructuring Directive to ensure that 'out-of-the-money' equity holders cannot unreasonably prevent the adoption of a restructuring plan that would bring the debtor back to viability.

Act 2016/2022 has also introduced certain provisions to facilitate the capitalisation of debt, which will often be one of the key measures in a restructuring plan, particularly when there is no equity value. For example, where the debtor is in a situation of imminent or current insolvency and the equity is considered to be 'out of the money', shareholders' legal pre-emptive rights are automatically excluded in simultaneous capital reduction to zero and capital increase transactions ('*operación acordeón*'), where the corresponding capital increase is carried out by means of debt capitalisation. This could ultimately result in the loss of shareholder ownership.

The above does not mean that shareholders cannot challenge a court-sanctioned restructuring plan (for example, if a class of creditors is receiving rights or shares with a value higher than their original claims because they manage to prove that there is a residual value in their equity which has not been taken into account in the restructuring plan).

Homologación judicial

The law seeks to maintain a principle of minimum judicial intervention. Thus, unless the court is asked to confirm the adequacy of the class formation, as mentioned above, court intervention is limited to the sanctioning (*homologación judicial*) of the restructuring plan. The *homologación* of a restructuring plan is necessary to cram down or cram up dissenting creditors, classes of creditors or shareholders, and to grant protection and payment preference to interim financing and new money, among other effects. For the restructuring plan to be sanctioned, the plan must offer a reasonable prospect of avoiding insolvency, ensure the debtor's viability in the short and medium term and treat creditors of the same class on a parity basis. Provided that the relevant requirements are met, the judge will sanction the plan within 15 days of the admission of the application for *homologación*, with immediate effectiveness of the plan once sanctioned.

A fundamental new feature introduced by Act 2016/2022 to facilitate the immediacy of the restructuring is the possibility for the relevant acts needed for implementation of the plan to access the relevant registers even if the plan is not yet final. In addition, if the plan contains measures requiring shareholder approval and the shareholders have not approved them, the debtor's directors (or, failing this, the person appointed by the judge at the proposal of any entitled creditor) will have powers to carry out those acts necessary for its implementation (including amendments to the articles of association, if needed).

Dissenting creditors or shareholders can oppose or challenge the *homologación* of a restructuring plan. The grounds for opposition/challenge vary depending on whether the plan was approved by all classes, and where applicable by the shareholders, or not. In both cases, one of the substantive grounds for challenge by individual dissenting creditors is based on the 'best interest of creditors rule', which allows dissenting creditors to file a challenge if they would have received more assets or rights in a hypothetical insolvency liquidation carried out two years after the plan's formalisation. In addition, the 'absolute priority rule' is introduced for the first time in Spanish law by Act 2016/2022. Thus, dissenting creditors within a dissenting class will also be able to challenge the plan where a lower ranking class, or the shareholders, have been granted any amount or rights or assets if the higher ranking class to which the challenging party belongs has not been paid all its claims. Other grounds relating to unequal treatment are also foreseen (e.g., non-parity treatment between classes belonging to the same rank or the granting to one or more classes of an amount or rights exceeding the value of their claims).

Conclusion

The changes introduced in the Spanish Recast Insolvency Act by Act 16/2022 will entail a far-reaching structural reform of the Spanish insolvency and pre-insolvency system, which will bring Spain more in tune with other neighbouring jurisdictions in such a key area. The new pre-insolvency system should provide greater comfort to creditors for the reasons outlined above, while reducing loss of business value to the benefit of both creditors and viable debtors. This is particularly relevant in the post COVID-19 business environment, where it is expected that a significant number of Spanish companies will have to undergo a restructuring process, once state aid and state-backed loans come to an end. It will be interesting to see how these new tools are applied in practice and the new negotiation dynamics they will surely bring about.

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