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I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

Spain began 2020 with a relatively stable outlook, having, as did many other countries, two main concerns in relation to financial markets: (1) Brexit and (2) the commercial tensions between the US and China. Additionally, a slowdown in the growth of the economy was expected, but this did not raise serious concerns as indebtedness ratios were not a significant concern and the banks were strongly capitalised. However, this all changed when the covid-19 pandemic broke out, affecting the entire world in a matter of weeks.

Upon the lockdown of the Spanish and European economies in mid-March, all expectations were dashed and efforts in both the private and public sectors have been exclusively focused on mitigating, to the extent possible, the effects of the pandemic.

Spanish banks have been focused on administering government support financing to SMEs and the self-employed, at a total cost of €100 billion, and applying the various temporary moratoria approved for consumer mortgages. They are also trying to waive or restructure payments in corporate financings during the crisis. This may prove to be a precautionary measure, but most of those financings will need to be severely restructured during the last quarter of 2020 and 2021.

Lastly, and although the current capital structure of Spanish banks was quite solid (CET1 ratio of 12 per cent) and the non-performing loans (NPL) ratio had been significantly reduced to below 4 per cent (from 13.6 per cent in December 2013), it is expected that the impact of covid-19 on the NPL ratio will probably lead to it exceeding the 2013 level, and therefore Spanish banks will again need to implement an active strategy of selling those NPLs at a similar or stronger rate than in the last five years.

ii Impact of specific regional or global events

The ECB has adopted a set of measures to provide the market with the necessary liquidity (Decision 2020/441, of 24 March, on the implementation of the corporate sector purchase programme, and Decision 2020/440, of 24 March, on a temporary pandemic emergency purchase programme, with an overall envelope of €750 billion). This is intended to provide liquidity to both the national banking systems and private actors so that they can meet the immediate needs arising from the economic slowdown and from the closure of and restrictions on certain businesses.

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An essential complement to the above, also aimed at increasing liquidity in the credit and capital markets, is the relaxation of the requirements affecting solvency and the equity of financial institutions, decided by the European Banking Authority (Decisions of 12 March and 2 April) in coordination with the ECB, thus providing temporary flexibility regarding the credit risk management system.

Lastly, the Spanish government approved Royal Decree Law 8/2020, by means of which grants guarantee up to €100 billion for the financing of business and self-employed workers aimed at covering their liquidity needs. The ministry also provided that up to €4 billion is for the benefit of issuers of commercial paper.

The above measures, together with others to be adopted at European and local levels, are deemed to ease the depth of the economic crisis, but with a forecast of a GDP decrease of more than 8 per cent and an unemployment rate of 21 per cent, all measures need to be focused on opening the economy and the recovery of international investments as soon as possible, targeting a strong recovery in the fourth quarter of 2021 and therefore avoiding a long and weak recovery with a dramatic impact.

iii Market trends in restructurings

For many years the Spanish Insolvency Act (SIA) proved extremely inefficient for protecting going-concern value and enabling the turnaround of economically viable companies in financial trouble. Most insolvency proceedings in Spain ended up in debtor's liquidation (which, nonetheless, permitted maintaining a going-concern business through its sale to the best bidder). As a result of the 'extend and pretend' processes, normally by the time the company was entering into insolvency proceedings, it was too late for a turnaround and recovery rates for creditors were low (less than 10 per cent of the claims for unsecured creditors in most cases).

The 2014 and 2015 amendments to the SIA promoted refinancing schemes at pre-insolvency stages, introduced certain restructuring tools and new rules that provided out-of-court solutions and reshaped it into a more flexible framework. At that stage, it was a revolution under Spanish law that dissenting creditors holding financial claims could be crammed down by a majority of creditors outside a full-blown insolvency proceeding. Since then, for instance, it has not been necessary to rely on foreign jurisdictions and instruments such as the 'English scheme' to achieve successful financial out-of-court workouts of Spanish companies.

In recent years, we have seen very large and well-known Spanish companies and conglomerates (particularly in the real estate and construction sector) involved in either pre-insolvency and out-of-court procedures or insolvency proceedings (e.g., Martinsa Fadesa, Metrovacesa, FCC, Abengoa, Grupo Isolux-Corsán, Bodybell, Celsa, Comsa, Codere, Prisa and Pescanova). During 2019 there were a few distressed restructurings exceeding €1 billion and expectations for large restructuring cases were low. However, the covid-19 crisis has suddenly altered this scenario and a tsunami of restructuring cases in all sectors is expected, many of which will surely move into insolvency proceedings.

At this first stage of crisis, restructuring processes are taking advantage of state financial aid through the Official Credit Institute to solve the liquidity difficulties of affected companies, but this will not be enough if the crisis continues for several months. Alternative lenders and private debt funds will be taking a relevant role in these restructurings at the end of 2020 and 2021, and they will also benefit from their experience in the previous financial crisis in Spain.

In the past, these funds usually replaced the banks' positions and became the catalysts of restructurings, in particular when they held the majority of the financial debt and could impose new terms on minority dissenters. Now, in general, companies face a liquidity issue that could be transformed into a structural capital problem if it is not managed adequately and the crisis continues. Thus, we anticipate that banks and funds should work together in restructuring solutions for these companies, in particular when new money is needed and state financial aid is no longer available. This will be the major challenge of the new wave of restructurings during covid-19 and post-crisis.

iv Number of formal procedures

Both creditors and debtors prefer out-of-court and pre-petition restructuring tools (individual and collective refinancing agreements, court-sanctioned refinancings (i.e., judicial homologations or 'Spanish schemes') and out-of-court payment agreements) rather than moving into formal judicial insolvency proceedings. In general, recovery rates are normally much higher at pre-insolvency stages.

The number of insolvency proceedings in 2019 stabilised at 4,483 cases, meaning 5 per cent fewer than in 2018. The regions of Catalonia, Madrid and Valencia still account for half of the total cases. Most of these insolvencies correspond to microbusinesses (80 per cent) and SMEs (19 per cent). Dissolutions amounted to 26,342 cases.

Covid-19 will undoubtedly increase such figures in 2020–2021. The new measures enacted by the Spanish government are aimed to avoid insolvency proceedings by means of the suspension of the debtor's duty to file insolvency by the debtor and of the creditors' rights for petition until 31 December 2020. Therefore, most of the insolvency cases and dissolutions processes will be moved into 2021. The Minister of Justice anticipates 50,000 insolvency cases in 2021 and a significant increase in 2020, in particular for SMEs.

In recent years, there have been a substantial number of judicial decisions of homologation of Spanish schemes. Many of these procedures have already been contested and objected to, because the SIA did not provide a clear solution for some complex situations and, therefore, the matter was subject to interpretation. Many of these controversial issues have been resolved by Spanish courts, and the framework is now much better defined, particularly, due to Royal Decree Law 1/2020, of 5 May, approving the Compiled Insolvency Statute (TRLC), which incorporates such case law and principles. The TRLC will be in force as of 1 September 2020.

There is a useful public register – the Insolvency Register – that allows anyone to check the status of any Spanish entity involved in insolvency proceedings and its judicial resolutions online (see https://www.publicidadconcursal.es/concursal-web/).

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Introduction to the insolvency regime

The SIA has been recently amended (by the TRLC). This has not been a real amendment, but is a systematisation of the law (needed after the different reforms carried out during the 17 years that have passed since SIA was approved). It has also included some (not all) of the case law from the Supreme Court. Although the TRLC will not enter into force until 1 September 2020, the references below are to the amended SIA.

The SIA foresees a *concurso* (the full Spanish insolvency proceeding) for companies that are not able (or expect not to be able) to regularly pay their debts as they fall due. The directors of a company or the debtor must file for insolvency within two months of the date on which they became aware or should have become aware of the insolvency situation. The TRLC includes a whole book to regulate pre-insolvency and out-of-court reorganisation agreements.

The SIA determines the equitable subordination of those claims held by persons with a special relationship to the debtor (insiders or connected parties). Connected parties are:

a shareholders with a direct or indirect equity stake of at least 10 per cent (or 5 per cent in listed companies);

b directors (also *de facto* or shadow directors) and those who had that role within two years prior to insolvency declaration;

c other group companies controlled by the same corporation or individual as the debtor company;

d shareholders who, despite not having the relevant stake in debtor's equity, do have it in another group company; and

e assignees of any connected party within two years prior to declaration.

Except in the case of directors, subordinated claims are only those accrued after the relevant fact or circumstance occurs. Equitable subordination affects any sort of claims, except in relation to shareholders ((a) and (d) above), where only financial claims are subordinated. The main effects of the subordination of the claims are (1) the cancellation of any security interests granted by the debtor; (2) deprivation of voting rights (although the claim will be bound by the restructuring agreement or plan of reorganisation); and (3) subordination in terms of priorities in distribution (i.e., rank at the bottom of the payment waterfall).

Unlike the US Bankruptcy Code, debtors (or creditors) do not have to make a decision between reorganisation (Chapter 11) or liquidation (Chapter 7) upon seeking judicial protection. Every insolvency proceeding begins with the common phase, which, however, may be coupled with other actions if the debtor's filing attaches, for instance, a prearranged proposal of composition agreement or a draft liquidation plan with a binding offer to acquire the business as a going concern. The common phase starts with the judge appointing an insolvency administrator (an independent third party – creditors have no say), who will be in charge of determining the debtor's estate and list of creditors (by producing the draft insolvency report). The insolvency administrator also oversees management of the debtor's business (default rule in voluntary cases) or steps into the shoes of the directors if so determined by the court (default rule in involuntary cases).

Creditors or any interested party may challenge the estate or the list of creditors. The common phase will not end until the court resolves these challenges, unless they represent less than 20 per cent of assets or claims, in which case the court may decide to proceed to next phase to reduce the length of the proceedings and preserve the value of the assets. Unless the debtor petitions for liquidation, the proceeding will move on to the composition phase as a default rule (no other party can petition for liquidation, except the insolvency administrator when business shuts down).

Summary insolvency proceedings may apply if the debtor: (1) has fewer than 50 creditors or its assets or liabilities do not exceed €5 million; (2) files with an early composition agreement proposal or a composition agreement with a corporate restructuring. Summary insolvency proceedings will be mandatory (1) when the company was inactive without workers or (2) if the debtor files for insolvency with a draft liquidation plan and a binding offer.

ii Pre-insolvency notice (automatic stay) of articles 583 to 595 SIA

Under Spanish insolvency law, directors must file for *concurso* within two months from directors' actual or due awareness of the debtor's inability to regularly pay its obligations as they come due. Failure to comply with this duty may have negative consequences for directors if they are found to have wilfully or grossly negligently created or deepened insolvency (a late petition is a rebuttable presumption thereof). Directors' liability is analysed within the frame of the insolvency classification section, which kicks in if the composition agreement sets forth haircuts or term extensions of at least a third of a year or three years for all classes or in the event of liquidation. In particular, in the event of liquidation directors may be liable for the impaired claims accrued from the onset of insolvency.

Debtors may earn an additional four-month period to continue negotiating a refinancing agreement out of court, an out-of-court payment scheme or a prearranged composition agreement. The First Title of the Second Book of the SIA establishes the proceeding to earn this safe harbour for directors. The debtor must serve notice with the court that would entertain *concurso* within two months from the onset of insolvency. The court merely acknowledges receipt (this is not an adversarial proceeding) and orders its publication in the Insolvency Register (unless the notice is confidential). The debtor has three months to continue negotiating, as a *concurso* petition must otherwise follow during the fourth month. Thus, considering that the debtor has two months to file for *concurso* or serve a pre-insolvency notice, borrowers have six months from the onset of insolvency to negotiate out of court instead of filing for *concurso*. In practice, so long as suppliers and workers are supportive or controlled, debtors may extend this period through standstill agreements (even seeking homologation thereof to bind dissidents as in the first *Abengoa* case; however, this remains highly controversial).

During this four-month period, the court shall not admit petitions for involuntary *concurso* (the debtor has preference to file voluntarily until the end of the fourth month).

A pre-insolvency notice also establishes an automatic stay, though this is limited to enforcement actions (e.g., security interests, monetary judgments – not payment, set-off, etc.) over assets necessary to continue the ordinary course of business. A standstill entered into between 51 per cent of the financial claims impedes lenders from initiating enforcement actions over any assets. Public claims (taxes, social security, etc.) are not affected by this automatic stay. Security interests governed by the financial collateral special regime or perfected on assets not located in Spain also escape this automatic stay (if the collateral is located outside the EU, the ability to escape the automatic stay shall rely on local insolvency law).

The debtor is allowed to file one pre-insolvencys notice per year. This is consistent with the SIA's goal of promoting restructuring alternatives to *concurso*, so long as the restructuring alternatives are actually suitable to remove financial distress.

iii Clawback actions (avoidance)

According to Article 226 SIA, a debtor's acts and contracts detrimental to the estate that were performed within the two years prior to the declaration of insolvency may be avoided, even in the absence of fraud or intent. The SIA establishes certain rebuttable and non-rebuttable presumptions of detriment to the estate.

The SIA also establishes certain safe harbours, mainly:

a acts and contracts pertaining to the ordinary course of business and at arm's-length terms;
b acts within the scope of special regulation over payment and clearing and liquidation systems for securities and hedging instruments;
c security interests granted in favour of the salary guarantee fund (FOGASA) or in connection with credit claims subject to public law;
d operations through which resolution measures of credit institutions and investment services companies are implemented;
e refinancing agreements gathering specific requirements; and
f acts or transactions subject to foreign law that are unavoidable under the circumstances.

Should the clawback action be successful, the act or contract will be rescinded. Concerning bilateral contracts, parties shall then return the consideration, having the non-insolvent party right to a pre-deductible claim (or subordinated if found to have acted with bad faith). As to avoided acts and contracts other than bilateral contracts, the creditor gets a claim (e.g., regarding debt-to-asset swaps, the asset must be turned over and creditor gets a reinstated pre-petition claim).

To avoid clawback risk, out-of-court refinancings and, in particular, the security interests taken can be ring-fenced from clawback through homologation and notarisation with certain additional requirements, as explained in the next subsection.

In addition to the insolvency law clawback action, generally applicable fraudulent conveyance actions, which require intent and have a four-year reach-back period, also work in *concurso*. Pursuant to the Spanish Supreme Court case law, intent is found to concur when a diligent creditor could not ignore that the act or contract at issue was detrimental for the estate or the rest of the creditors. This general fraudulent conveyance action is the only one applicable to unwind security interests subject to the financial collateral regime.

iv Formal methods to restructure companies in financial difficulties (within insolvency proceedings)

Insolvent companies have the following mechanisms available under the SIA to restructure their debts.

Composition agreements

An insolvent debtor may restructure the company's debt by entering into composition agreements with its creditors. The SIA foresees two proceedings to approve said composition depending on when it is filed (early or ordinary file).

Composition agreements include term extensions (up to 10 years) or haircuts (or both). They may also establish corporate restructurings such as mergers, the sale of assets or business units as a going concern (with the same rules described in Section II.ii), debt-to-asset swaps and conversion into subordinated loans (PPL) or into any other debt instrument. Other alternatives are also available. These measures, other than haircuts and term extension, cannot affect public creditors. Moreover, under no circumstance can composition agreements determine the global liquidation of a company. The proposal for a composition agreement shall include a repayment schedule and a business plan (if the debtor expects to repay the debt with the ordinary course cash flows).

For voting and recovery purposes, claims are classified into secured, generally privileged (unsecured but with priority in distribution), ordinary unsecured and subordinated claims. Secured and generally privileged claims are also classified into financial, trade, public and labour claims. Secured claims are stripped down in accordance with the security interest value (nine-tenths of collateral fair value). The deficiency claim is classified according to general rules.

Concerning voting, there is no cross-class cramdown or absolute priority rule (although this will change with the implementation of the EU Preventing Restructuring Framework Directive). Spanish insolvency law relies on cram-in rules. Moreover, in spite of valuation, subordinated creditors, who have no voting rights, are entitled to the same treatment as ordinary unsecured claims (although deferred – if the composition agreement includes debt deferrals, those terms will be counted for subordinated creditors as from the expiry of the forbearance period of ordinary creditors). Finally, yet importantly, there are no equity cramdown mechanisms. The debtor can bargain with the right to petition for liquidation at any point in time (even if the composition agreement proposal comes from creditors and obtains the relevant majority thresholds). The only exceptions thereto are homologated refinancing agreements with an independent valuation working out the debt-to-equity swap fairness.

Composition agreements with haircuts of up to 50 per cent or term extension (or conversion into PPL) of up to five years require a majority of 50 per cent of ordinary unsecured claims. This threshold is 60 per cent for secured and generally privileged claims. Any other content requires a 65 per cent majority threshold for ordinary unsecured creditors and 75 per cent for secured and generally privileged creditors. A simple majority is sufficient if there is full payment within no more than three years or immediate payment with a haircut lower than 20 per cent. There is a specific voting rule established for syndicated creditors. The whole syndicate accepts the composition agreement if 75 per cent of participants favour the proposal, unless a lower majority is provided in the syndicated agreement.

Ordinary composition agreements

The debtor or creditors (with the support of 20 per cent per cent of the claims) may submit ordinary composition agreement proposals no later than 40 business days before the creditors' meeting or one month before written votes should be submitted. Voting may be in writing (if there are over 300 creditors) or at a creditors' meeting.

Early (pre-arranged) composition agreements

Only debtors are entitled to submit early composition agreement proposals at an early stage of the insolvency proceedings and may do so at any time from filing for insolvency, subject to certain restrictions linked to directors' failure to comply with their management duties. The debtor needs the support of 20 per cent of the claims (or 10 per cent if the proposal is filed with the petition for insolvency).

Sale of business unit (pre-pack sales)

The business unit can be sold off at any time during the insolvency proceedings with the authorisation of the insolvency administrator and court approval (usually through auctions, although direct sales are also possible). Moreover, the SIA provides a specific type of accelerated pre-packaged sale when a debtor simultaneously files for insolvency and liquidation with an agreed binding offer.

An important aspect of the sale of business units or pre-packaged sales is that the purchaser can assume or reject (without having to pay damages) executory contracts, licences and administrative permits.

The purchaser can also leave behind the debtor's debts (both insolvency claims and administrative expenses) except for labour claims and social security claims (however, an important change has been introduced in SIA, as only the insolvency court can establish the business unit). Cherry picking certain claims (normally for business reasons) is also permitted. Importantly, no taxes or tax contingencies are transferred to the purchaser. In practice, however, the deal structure becomes paramount to minimise the accrual of taxes related to the very sale of the business unit.

The business unit can also be transferred free of any liens and security interests (although the purchaser may elect to assume secured financial contracts, in which case the security interest is not cancelled). The statutory rule is that secured creditors who fail to enforce the security interest ahead of liquidation lose control over the collateral, although they maintain the right to receive part of the price equivalent to the weight of the collateral in the estate. On the other hand, if secured creditors have already initiated enforcement proceedings and the collateral is included in the business unit, they have veto right unless (1) they receive a percentage of the price equivalent to the value of the security interest (nine-tenths of collateral fair value) or (2) 75 per cent of the secured claims from the same class (public, labour, financial or trade) so consent.

v Out-of-court mechanisms to restructure companies in financial difficulties

Out-of-court refinancing agreements

Spanish law regulates collective refinancing agreements and non-collective or individual refinancing agreements. Both refinancing agreements and their security interests enjoy protection against clawback actions, and lenders' claims will not be equitably subordinated as for old and fresh money given as part of the refinancing.

Collective refinancing agreements are those entered into by the debtor and creditors whose claims represent at least 60 per cent of the debtor's liabilities (as evidenced by a certificate issued by the debtor's auditor). Collective refinancing agreements must:

a be supported by a viability plan allowing the continuity of the business activity in the short and medium term;
b involve a significant increase of available credit, or the amendment of existing obligations (either through rollover or maturity extension); and
c be notarised before a Spanish public notary.

Individual refinancing agreements are those available when collective refinancing agreements are not possible. These refinancing agreements shall meet the following requirements:

a the ratio of assets over liabilities is improved;
b the resulting amount of current assets is not less than the current liabilities;

c the value of the security interests (calculated according to SIA criteria) does not exceed nine-tenths of the value of the outstanding debt owed to the creditors participating in the agreement, and does not exceed the previous ratio between security interests and the outstanding debt owed to such creditors;

d the interest rate of the existing debt or debt resulting from the refinancing agreement does not exceed the interest rate applicable to the previous debt by more than a third; and

e it is executed as a public deed before a Spanish public notary.

Half of the new money extended as part of an individual or collective refinancing agreement (homologated or not) earns the administrative expense treatment in the event of *concurso* (the other half enjoys a priority in distribution ahead of ordinary unsecured claims).

Court-sanctioned scheme of arrangement (homologation proceeding)

The SIA regulates court-sanctioned workouts, which are a proceeding in which a collective refinancing agreement supported by at least 51 per cent of the financial claims (excluding public, labour and trade creditors) is sanctioned or homologated *ex post* by the court to protect it against insolvency clawback actions.

In addition to protection against the insolvency clawback action and the new money incentive, the most relevant effect of the Spanish scheme is that it allows the extension of effects – through a cram-in mechanism – to dissenting and holdout creditors with unsecured and secured financial claims. In this regard, secured claims that exceed the value of its collateral will be treated as unsecured claims for the non-covered portion (the deficiency claim). On the other hand, Spanish law does not foresee any mechanism to cram down equity holders. However, shareholders of the debtors may be personally liable in the event of liquidation when they reject, without a reasonable cause, a debt-to-equity proposal based on a fairness opinion that frustrates a collective refinancing or a court-sanctioned scheme. As far as we are aware, this liability regime, which presents certain technical and practical issues, has not yet been applied in practice.

The majority thresholds to extend the refinancing agreement to holdouts depend on the content and on whether such holdouts' claims are secured or unsecured.

When dealing with unsecured financial claims: (1) the majority threshold is 60 per cent of the claims to extend term extension up to five years or conversion into profit participating loans with a term up to five years; and (2) a majority threshold of 75 per cent of the claims to extend term from five to 10 years, unlimited haircuts, debt-to-equity swaps, debt-to-asset swaps, conversion into profit participating loans with a term from five to 10 years, and conversion into different financial instruments.

Regarding secured financial claims, a majority of 65 per cent of the secured claims (calculated by value of the security interest as defined by the SIA) is required as for (1) above and 80 per cent of the secured claims in relation to (2) above.

The concept of financial debt has been very controversial. According to recent cases (namely *Abengoa*), contingent debt that has not yet crystallised should not be affected debt for homologation purposes. In those cases, the only way to refinance dissident contingent debt would be a composition agreement in *concurso*.

For the purposes of calculating such percentages, claims held by specially related parties to the debtor (in general, shareholders over 10 per cent or 5 per cent, directors and other entities part of the same corporate group) are not counted. There is also a special rule for syndicated instruments, by which where more than 75 per cent of the claims support the refinancing, the whole syndicate is deemed to support it.

Holdout creditors may challenge the judge's homologation ruling based on two limited grounds: (1) existence of disproportionate sacrifice (a concept subject to several constructions by the courts, but which includes a liquidation test and the need to treat equally those who are *pari passu*); and (2) failure to meet the majority thresholds. The debtor can only apply for one homologation process per year, although in *Abengoa* there were two homologations (a standstill and refinancing agreement) on the basis that the second one was filed by lenders, which remains controversial.

Out-of-court payment schemes

Dissenting creditors can also be crammed down by means of this straightforward mechanism only applicable to individuals and small companies (companies with less than 50 creditors, estimated liabilities or estimated assets of €5 million or less and for extension of terms up to three years). Both extensions of up to 10 years and write-offs are available subject to approval by a 60 to 75 per cent majority of claims. However, debtors have not taken much advantage of this, and it has been rarely used owing to lack of creditors' support.

vi Taking and enforcement of security

Taking security

Under Spanish law, obligations can be secured by *in rem* rights (e.g., mortgages over real estate) where a specific asset secures fulfilment of an obligation, or *in personam* guarantees, where a person guarantees fulfilment of an obligation. There are also material differences in proceedings for their enforcement (as explained below) and their treatment during insolvency under the SIA where creditors with collateral over specific property or rights (e.g., mortgage or pledge), or equivalent rights (e.g., finance lease agreements) are classified as privileged creditors and are only bound by the composition if they accept it voluntarily or through cram-in mechanisms.

Real estate mortgages cover not only land and buildings built on it, but also automatically proceeds from the insurance policies related to the property, improvement works and natural accretions. Parties may also agree to extend the security interest over movable items located permanently in the mortgaged property for its exploitation, proceeds of the mortgaged property and any outstanding rent. They must be granted by means of a public deed before a public notary and filed at the relevant land registry.

Obligations can also be secured by means of a chattel mortgage. This particular type of mortgage can cover the whole business of the grantor (including leases, fixed installations, equipment, intellectual and industrial property, and raw materials and finished goods, if certain requirements are met), motor vehicles and aircraft. Industrial machinery and IP rights can also have their own separate type of security. These mortgages must be executed by means of a public deed before a public notary and entered on the chattel registry.

Since March 2016, aircraft equipment can also be subject to 'international interest' under the Cape Town Convention on International Interests in Mobile Equipment. The only requirements are to be set out in writing (identifying the object and the guaranteed obligations) and the guarantor's title to dispose of them. Entry on the International Registry of Guarantees is a requisite for enforceability against third parties. International interests have priority over any state security regulated by domestic law, even where the state security was created before, and are enforceable in insolvency proceedings if they were registered before the proceedings began (the international interest would be treated in the insolvency as a national *in rem* security).

For movable assets that cannot be the object of a chattel mortgage (because their specific identity cannot be registered), or of an ordinary pledge (given the legal or financial impossibility being transferred), Spanish law regulates the non-possessory pledge. Movable assets that may be involved in this sort of pledge are row materials and stock, and machinery. Claims not represented by securities or considered financial collateral (under the Collateral Directive and its transposition under Spanish law) can also be used in a non-possessory pledge. The law requires entry on the Chattel Registry as a condition for validly creating the pledge.

Pledges can also be granted with transfer of possession to the creditor or a designated third party. For the pledge to be enforceable against third parties, a notarised agreement or a public deed must be created. The most common type of ordinary pledge is given over shares and credit rights (such as bank accounts, receivables, relevant agreements and insurance policies).

In Spain, a personal guarantee may be granted by means of a an ancillary guarantee or by means of an *aval* or a first demand independent guarantee. The aim of a first demand guarantee is to provide the beneficiary with faster and summary means of enforcement, avoiding unnecessary costs and delays derived from certain benefits and privileges conferred by Spanish law to any guarantor under an ordinary guarantee (i.e., exhaustion of remedies against debtor, division between several guarantors or main debtor and guarantor and requesting payment only after seeking first from the main debtor). In terms of enforceability of first demand guarantees, the court should not analyse the guaranteed obligation, since the first demand guarantee is an abstract, independent and autonomous obligation with respect to the loan agreement.

The most common types of security given in Spanish practice are personal guarantees and pledges over assets (i.e., shares) and claims, since they are not subject to registration (and, therefore, not subject to registration fees or taxation). Stamp duty can be triggered when granting or assigning security if granted by means of a public deed and subject to public registration.

Property mortgages are also a very usual security when the value of the property justifies the payment of the stamp duty and other related costs. More recently, floating mortgages (Article 153 *bis*) are popular since they can secure several financial obligations and, consequently, prove cost efficient, but are only available to credit institutions. Other securities also subject to registration (such as mortgages over machinery or trademarks and pledges without transfer of possession over stock or raw materials) are less common because of the stamp duty and costs involved.

Lastly, some Spanish autonomous regions, particularly, Catalonia, have approved local regulation on security interests that applies primarily to pledges and differs from Spanish common law in key aspects.

Enforcing security

Under Spanish law, mortgages and pledges can be enforced in judicial or notarial proceedings. In judicial proceedings, the asset can be realised by direct sale, by a specialist entity or through an auction. Notarial proceedings can only be carried out by auction. In both proceedings, auctions must be carried out through an electronic auction held on the Official Gazette of the

Spanish state's auctions portal. Pledges over credit rights are usually enforced by offsetting or direct transfer. Direct sales are still controversial, but should be acceptable if executed at fair value and including escrow mechanisms for junior creditors.

Personal guarantees can be enforced either through declaratory civil proceedings or summary executive proceedings, the latter when certain conditions are met (granted by means of a public deed where the secured obligation is clearly specified). Summary executive proceedings are faster and more effective, while the declaratory civil proceedings are more time-consuming.

At pre-insolvency stages, the SIA limits the possibilities of enforcing collateral required for the continuity of debtor's professional or business activity (with the exception of financial collateral). In addition to the 5 *bis* notice (see Section II.ii), upon insolvency declaration, enforcement may not commence until a composition is approved (which does not affect that entitlement) or one year elapses without composition or liquidation (with the exception of financial collateral). For this purpose, the law extends the treatment to the recovery of movable property sold by instalments and those assigned by financial leases, as well as to the cancellation of real estate sales owing to failure on payment of the deferred price.

Although regulation to restrain foreign investment has been enacted, our view is that the rationale should not apply to foreclosure of security interests.

vii Duties of directors and liabilities; guilty insolvencies

Under Spanish law, there is no shift of directors' fiduciary duties to creditors when approaching or during insolvency. Having said that, when a company is in financial distress, directors may be found liable in certain specific cases.

Spanish companies' directors must perform their duties with the diligence of a careful entrepreneur (duty of care) and loyal representative (duty of loyalty).. In addition, directors can be jointly and severally liable for corporate debts if they breach their duties relating to winding up the company. If losses reduce equity to less than half of share capital, directors must call a general meeting within two months to pass the resolution to wind up the company or, if the company is insolvent, to petition for insolvency proceedings.

The two-month term for calling a general meeting runs from the date the directors became aware or should have become aware of the cause for winding up. If the general meeting fails to do so, the directors must seek a court-ordered winding up of the company.

Breaching these obligations is enough to incur directors' liability, regardless of any damage to creditors, directors' culpability or a causal link. Consequently, a creditor may claim the full amount of the debt from any director if accrued after the onset of the capital imbalance scenario.

In insolvency situations, the directors' liability regime is only triggered when it is necessary to categorise the insolvency (i.e., when the liquidation phase starts or in some cases when a composition agreement is reached) as either fortuitous or culpable. Insolvency is categorised as guilty when the insolvency situation is created or aggravated by the willful misconduct or gross negligence of the formal or *de facto* directors, general proxy holders or any person who had that status within the two years before the insolvency declaration.

The SIA provides for certain *iuris et de iure* (no contrary evidence is admitted) assumptions of guilty insolvency (e.g., the material breach of accounting duties) and *iuris tantum* (unless proved otherwise) assumptions of culpable insolvency (e.g., breaching the duty to timely petition insolvency declaration).

Directors in a guilty insolvency can be disqualified from managing third-party assets for a term of two to 15 years and can lose any right as creditors in the insolvency and indemnity for the damage caused. Additionally, in the event of liquidation, when the insolvency estate is insufficient to cover the claims, the court may order directors declared affected by the categorisation to cover all or part of the deficit.

III RECENT LEGAL DEVELOPMENTS

The Spanish government has enacted several pieces of urgent legislation to prevent and reduce the negative impact of covid-19, particularly dealing with the insolvency risk of Spanish companies due to their lack of liquidity within the following months.

First, Royal Decree-Law 8/2020, of 17 March, on urgent extraordinary measures to face the economic and social impact of covid-19 (RDL 8/2020) focused on avoiding the risk of debtors having to face insolvency. Article 43.1 provides that no debtor will be required to file for insolvency proceedings during the state of emergency (although they will still be able to do so if they wish), thus preventing company directors from being liable for not applying in due time and form. Moreover, courts will not grant any applications filed by creditors (compulsory insolvency proceedings) during the state of emergency or until two months after its end. In addition, debtors' applications for voluntary insolvency proceedings will be prioritised. On the other hand, Article 43.2 of RDL 8/2020 establishes that debtors that have notified the court that negotiations have been opened with creditors, as provided under Article 5 *bis* of SIA, will not be required to file for insolvency proceedings during the state of emergency even if the deadline provided in it is exceeded. Finally, RDL 8/2020 establishes that the grounds for dissolution will not apply during the state of emergency, thereby suspending all judicial deadlines and proceedings.

Second, Royal Decree-Law 16/2020, of 28 April, on measures applicable to the administration of justice (RDL 16/2020), entered into force on 30 April. It mainly provides that:

a insolvent debtors' obligation to file for insolvency has been suspended until 31 December 2020. During this period, creditors' rights to apply for the debtor's insolvency will not be considered;

b court-sanctioned refinancing agreements can be amended, even if a year has not elapsed since the previous approval; and

c there is improved treatment of financing by inside parties or closely related parties. This will foster shareholders contributions' and funding to solve the lack of liquidity. For instance, in insolvency proceedings filed within two years following the declaration of the state of emergency, (prior and post-petition) financing granted by closely related parties or financing in which they have been subrogated as creditors (due to payment) would not be subordinated, but rather considered as ordinary claims (although it would not benefit security interests).

Finally, Royal Decree Law 1/2020, of 5 May, approving the Compiled Insolvency Statute, will be applicable from 1 September 2020. The TRLC redrafts the existing SIA in a more systematic way, but it also incorporates the case law set up by the Supreme Court in recent years. A few new issues are also introduced, such as the rule that no interests are accrued since the declaration of insolvency. Spanish Supreme Court case law established in 2019 that secured claims only accrue ordinary interest (not default interest) post insolvency declaration so long as secured creditors include in their proof of claims a contingent claim tied to ordinary interest to be accrued post-petition.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The crisis in Spain has affected severely all sectors. However, construction companies, real estate developers, retailers, manufacturers and some financial institutions are the ones that have suffered the most. Even at this economic stage, Adveo and Lecta are both good examples.

i Adveo: pre-pack sale

The Adveo deal was a pre-pack transaction across five jurisdictions. Our company's key added value was successful leadership to achieve an agreement among the stakeholders (shareholders, board, managers, banks, insolvency administrator and pre-petition creditors) where two prior bidders had failed. We also succeeded in getting judicial authorisation to pursue a direct sale instead of an auction.

In this transaction, the bidder provided post-petition financing and acquired the 'good business' in consideration for a price that permitted it to pay the claims of the 'bad business', which was liquidated. The banks gained the real estate assets (their proceeds), securing their debt and assigned the deficiency claim to the bidder, who restructured it at the good business level, discharging the bad business of their obligations thereunder.

ii Lecta: 2020 restructuring

In 2020 the Lecta group entered into a financial, debt and corporate restructuring, where we successfully assisted certain creditors during the restructuring and in the implementation of the operation in Spain. The Lecta restructuring was backed by an English scheme of arrangement which did not provide *per se* specific protections in Spain and there were no precedents as to how the English scheme of arrangement could be recognised or protected in Spain.

Together with the company, we managed to homologate the Lecta restructuring agreement, which granted:

a protection to the Spanish restructuring agreement from potential clawback actions that could potentially be filed (the deal is now ring-fenced in Spain);

b protection to the new money granted within the restructuring agreement, which now has an even higher standard of protection in the event of insolvency of the Spanish perimeter (super senior treatment over 50 per cent of the new money); and

c protection from equitable subordination to those creditors that capitalised their claims within the restructuring agreement (presumption that such creditors are not related parties to the debtor).

This transaction sets an important precedent when it comes to the homologation of the Spanish perimeters.

V INTERNATIONAL

The new European Regulation on insolvency proceedings (EU Regulation 2015/848, recasting EU Regulation 1346/2000) entered into force on 26 May 2017. One of the goals of EU Regulation 2015/848 is the inclusion in Annex A of all new restructuring proceedings (alternative to full-blown insolvency proceedings) enacted across the EU. In the case of Spain, insolvency notices, homologation and out-of-court payment schemes are now automatically recognised in the EU.

Concerning the reorganisation of companies with their COMI in Spain and multi-jurisdictional debt instruments, we expect homologation to remain the restructuring means chosen to deal with these cross-border cases. Homologation passed muster for the Chapter 15 recognition test in both the *Abengoa* and *Isolux* cases. Most importantly, absent a COMI shift, other alternatives (such as Chapter 11 and scheme of arrangements) present significant issues when it comes to cramming down dissenters with recourse to assets located in Spain. First, Spanish courts shall not recognise foreign main proceedings where the jurisdiction is not based on COMI location or similar criterion. Second, any creditor would always be entitled to seek a non-main proceeding in Spain, undermining the benefits of a global and comprehensive reorganisation. Third, in the absence of a non-main insolvency proceeding in Spain, secured creditors with collateral located in Spain would be able to bypass the main insolvency proceeding automatic stay and be instead subject to the Spanish insolvency law automatic stay.

Finally, yet importantly, concerning clawback risk, Spanish courts shall provide protection to creditors, purchasers and other third parties under contracts subject to non-Spanish law, according to which the contract or act at hand would be unavoidable under the circumstances (see, recently, the ruling from Palma de Mallorca Court of Appeals of 17 October 2017 – *Orizonia* case). Within EU territory, the ECJ ruling of 8 June 2017 (*Vinyls Italia SpA*, C-54/16) has confirmed the ability of the parties to have a contract governed by foreign law even where all the links are tied to the same country (Italy), absent fraud, which must be determined by the insolvency court.

VI FUTURE DEVELOPMENTS

Further to the systematisation of restructuring and insolvency law under Legal Royal Decree 1/2020, of 5 May, which will enter into force on 1 September 2020, comprehensive insolvency law reform is currently pending from the implementation of the European Directive on preventative restructuring frameworks, 'second chance' and measures to increase the efficiency of restructuring, insolvency and discharge procedures.

Appendix 1

ABOUT THE AUTHORS

FEDRA VALENCIA GARCÍA

Cuatrecasas

Fedra Valencia is a partner at Cuatrecasas and a renowned specialist in the legal management of bankruptcy proceedings and legal advice on corporate and financial restructuring transactions. She has participated in several bankruptcy proceedings, including some of the most relevant on a national scale, defending the interests of both debtors and creditors, as well as in debt-refinancing transactions (both in and out of court) and corporate restructuring agreements, which were beneficial for her clients with respect to their creditors. She is also an expert in administrative liability.

Throughout her professional career, she has advised and represented various debtors in the preparation, presentation and follow-up of bankruptcy proceedings, including many companies in the real estate and industrial sectors, as well as participating in agreement proposals and ad hoc processes arising from the aforementioned proceedings, both ordinary and reintegration.

She has also represented the interests of creditors, providing advice to financial institutions and companies in corporate bankruptcy proceedings for a wide variety of sectors, including the air transport, automobile, construction and energy sectors.

ÍÑIGO DE LUISA MAÍZ

Cuatrecasas

Mr de Luisa is a partner at the Cuatrecasas Madrid office. Since 1996, he has specialised in banking and financing transactions, particularly those with international exposure. He has ample experience in leveraged and acquisition finance, corporate finance, project finance and direct lending, etc. His sector expertise covers a wide range of asset classes, with a strong focus on real estate, energy (renewables) and infrastructure.

He has also advised on complex debt restructuring and refinancing deals at pre-insolvency stages (including the Spanish schemes and judicial homologation cases) and participated in several transactions advising international investors in the acquisition of distressed debt and non-performing loans portfolios (both secured and unsecured). He was directly involved in the incorporation of the Spanish bad bank (Sareb) and its transfer of impaired assets (€51 billion). More recently, he has participated in bidding processes of loan portfolios on the buyer's side and debt-for-equity and debt-for-assets situations in restructuring processes.

From 1999 to 2000, he was an international associate in the banking group of Simpson Thacher & Bartlett in New York. From 2006 to 2008, he was based at Cuatrecasas' London office, where he was responsible for the finance practice.

IÑIGO RUBIO LASARTE

Cuatrecasas

Mr Rubio is a partner who specialises in advising on the financing of infrastructure projects (public private partnerships and private finance initiatives) and real estate projects, whether simple, syndicated or structured (e.g., sale-and-leaseback and off-balance-sheet transactions).

He also has ample experience in corporate and asset finance, and debt restructuring transactions, having participated in several of the most important and complex refinancing processes of recent years. Recently, Mr Rubio has been involved in advising institutional investors in their acquisition of NPL portfolios from the Spanish financial entities. Since joining Cuatrecasas, Gonçalves Pereira in 2000, Mr Rubio has developed most of his career in the firm's offices in Madrid and then London, where he was managing partner between 2010 and 2013.

Mr Rubio is recommended by several directories, including *Chambers Europe*, *Chambers Global*, *Best Lawyers* and *The Legal 500* in real estate and corporate and M&A, banking and finance, project finance (Spain and the UK) and public finance.

CARLOS ARA TRIADÚ

Cuatrecasas

A senior associate in the litigation practice and qualified to practise in Spain and in the state of New York, Mr Ara specialises in cross-border restructuring and insolvency (both out-of-court workouts and judicial proceedings). He is an expert in European and Spanish insolvency law, with extensive experience in advising lenders, debtors, directors and bidders in high-profile cases across almost all industries.

He regularly collaborates on structuring transactions to address potential litigation and insolvency issues. Recent work includes loan-to-own transactions and cross-border rescue financings, to tackle new money privileges, as well as clawback and automatic stay risks.

As a litigator, Mr Ara also has experience in security interests, directors' fiduciary duties and corporate and M&A-related disputes.

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