The Restructuring Review

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Editor
Peter K Newman

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THE RESTRUCTURING REVIEW

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PREFACE

I am very pleased to present this 14th edition of *The Restructuring Review*. Our intention is to help general counsel, government agencies and private practice lawyers, as well as other professionals, investors and market participants, understand the prevailing conditions in the global restructuring market in 2021. This edition seeks to highlight some of the more significant legal and commercial developments and trends during this period.

I would like to thank Chris Mallon, the editor of the first 12 editions of this book, and Dominic McCahill, the editor for the 13th edition, for their time and dedication to ensuring the publication of this review on an annual basis. Both have now retired from the partnership at Skadden and I am honoured to continue their work.

The covid-19 pandemic has dominated the global political and economic landscape since it emerged in early 2020 and will continue to do so throughout 2021. The impact of the pandemic has been felt far and wide, from the devastating human costs to the severe impact on the world economy. All countries have faced material consequences from the pandemic and the vast majority have imposed multiple lockdowns and sweeping travel restrictions to help fight the spread of the coronavirus through their populations. At the time of writing, no country has emerged from the pandemic and all countries maintain some level of restrictions on movement and interaction of people to limit virus spread.

The world economy faced extreme challenges in 2020 due to the pandemic. Faced with total losses of revenue at the outset of the pandemic, businesses in many sectors appeared likely to be swept into a tidal wave of insolvencies and liquidations. Many workers lost jobs and the prospect of extreme levels of unemployment appeared imminent. But at least in some significant respect, the blow was softened by financial support to businesses and workers offered by governments and central banks around the world. In fact, government support measures in many cases more than offset (at least temporarily) the damage wrought by the pandemic as many jurisdictions reported year-on-year decreases in restructuring and insolvency activity. Markets around the world continued their pre-pandemic ascents and deal activity hit new record highs, including in an exuberant market for blank cheque acquisition vehicles known as 'SPACs'.

The development of numerous vaccines and the commencement of unprecedented global roll-outs of vaccination programmes has brought hope that brighter days are ahead in 2021 and 2022. While some have predicted that the world economy will recover rapidly in 2021 and 2022 as vaccine distribution proliferates and countries ease or eliminate pandemic related restrictions, others warn of a rude awakening as new covid-19 variants emerge, government support measures are withdrawn and pandemic-inspired changes to consumer behaviour impact businesses built in a pre-covid world. Only time will tell how quickly the world is able to recover from the pandemic as well as when, and to what extent, the world will return to pre-pandemic life.

In light of all this unprecedented disruption, it is unsurprising that the past year has been an interesting one in the restructuring and insolvency space. Last year, many jurisdictions introduced new laws, rules and practices related to the restructuring and insolvency of troubled businesses. While some of these changes arose specifically in reaction to covid-19, many others were introduced as part of a broader trend of reform of insolvency and restructuring law many years in the making. As can be seen in the following chapters, many of these new laws and reforms have already been used to help businesses in an exceptionally challenging year and no doubt will continue to be used and further developed in the global efforts to recover from the pandemic.

I hope that this edition of *The Restructuring Review* will continue to serve as a useful guide at a crucial moment in the evolution of restructuring and insolvency law and practice internationally. I would like to extend my gratitude to all the contributors for the support and cooperation they have provided in the preparation of this work, and to our publishers, without whom this would not have been possible.

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Skadden, Arps, Slate, Meagher & Flom (UK) LLP
London
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Chapter 19

SPAIN

Fedra Valencia García, Íñigo de Luisa Maíz, Íñigo Rubio Lasarte and Carlos Ara Triadú[1]

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

The covid-19 pandemic has been the main factor of influence not only on the financial markets, but also in all economic sectors during 2020 and 2021. The Spanish government followed other European government schemes by putting together a set of measures to provide financial support to companies and individuals. The main measures were (1) government guarantees for banks lending to small and medium-sized companies (SMEs) and self-employed people whose activity had been affected by covid-19 for a total of €126 billion; (2) mortgage moratoria for individuals for a total of €20 billion; (3) mortgage moratoria for the tourism sector that are still available and that it is hoped will help the sector's recovery in the summer of 2021; and (4) the incorporation of a fund for acquiring equity interest and providing finance to strategic companies with a maximum amount of €10 billion, of which around €1 billion has already been committed as of May 2021.

Although the above measures have proved helpful, the depth of the economic crisis is raising the need to restructure a significant part of the €126 billion government-backed financings. Most of the restructuring will probably consist of pure amortisation extensions, but the government has recently approved a regulation by means of which the banks can approve partial write-offs in certain circumstances.

Given the measures outlined above, together with the suspension of the obligation to file for insolvency until December 2021, the size of the restructuring market has been lower than initially expected, but the expectation is that once the economic situation has stabilised, probably in the fourth quarter of 2021 and the beginning of 2022, a significant increase in financial restructurings will come to the market.

Lastly, in the non-performing loans (NPL) market, after the shock of covid-19 on the Spanish financial market that implied the paralysation of the NPL sale processes by the banks, the fourth quarter of 2020 showed foreign investors have a strong interest in acquiring NPL portfolios, both on the secured and the unsecured areas. The NPL ratio of the Spanish banks is still low (around 5 per cent), but it is expected that once the various covid-19-related schemes (government guarantees, moratoria, etc.) end, the NPL ratio will increase significantly. The European Central Bank (ECB) has already announced that the relaxation of

1 Fedra Valencia García, Íñigo de Luisa Maíz, Íñigo Rubio Lasarte and Carlos Ara Triadú are partners at Cuatrecasas.

the requirements affecting solvency and the equity of financial institutions should be reviewed and, therefore, Spanish banks will re-engage in managing the €76 billion of impaired assets still being held on their balance sheets.

ii Impact of specific regional or global events

Again, covid-19 has had an unprecedented impact on the world economy and, among developed economies, Spain's has been one of those hit hardest. GDP decreased in 2020 by 10.8 per cent and started 2021 with an additional decrease of 0.5 per cent in the first quarter. Additionally, the unemployment rate increased to 16 per cent (not taking into consideration the employees subject to temporary work suspension), which had a significant impact on younger employees, where the unemployment rate is 40 per cent in those under 25.

The main reason for the more severe impact on Spain is that as a result of the lockdown, the main source of income – tourism and all the activities linked to hospitality and leisure (which account for more than 15 per cent of GDP) – were suspended for a significant part of the year and are still very far from pre-covid-19 levels. The government measures implemented as a matter of urgency in 2020 and 2021 have been useful for mitigating the impact of the crisis, but hopes are now concentrated on the proper vaccination of the population and the reactivation of the economy by opening the borders to foreign investors and welcoming European rescue funds.

Once this important objective is achieved, we believe that the recovery of the Spanish economy should be significant and strong, providing opportunities for investment. As mentioned, tourism is one of the sectors where we expect a significant increase in activity and Spain being the second receptor of tourists in the world will make it an attractive market for investors and there is already a significant number of transactions on the market and more to come.

Lastly, the concentration of the Spanish banking system with the recent merger between CaixaBank and Bankia (now the largest bank in the Spanish market), as well as the announced merger between Unicaja and Liberbank, together with the lack of flexibility of Spanish banks in the restructuring process, should prove an opportunity for alternative lenders to increase their presence in the Spanish market in order to take a significant role in the financial restructuring that will come once the economy is stabilised and accurate financial projections are made.

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. The covid-19 crisis suddenly altered this scenario and a tsunami of restructuring cases in all sectors is expected, many of which will surely move into insolvency proceedings in 2022. This two-year suspension period of new insolvency proceedings is too long for many companies that are postponing their unavoidable fate due to the capital structure deterioration.

At this first stage of crisis, restructuring processes are taking advantage of state financial aid through the Official Credit Institute (ICO) to solve the liquidity difficulties of affected companies and through Spanish Estate Holding Conglomerate (SEPI) to rescue Spanish relevant companies in financial distress. Alternative lenders and private debt funds have been 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. Other investors are waiting for the right time to enter a more distressed market where neither the state nor the banks will be willing to financially support these companies.

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 (and more frequently now the state too as shareholder or debtor) should work together in restructuring solutions for these companies. 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 economic crisis stemming from covid-19 has not changed this approach.

After several years in which the number of insolvency proceedings was stable, covid-19 brought huge uncertainty, in particular for SMEs, entrepreneurs and professionals. Surprisingly, in 2020 insolvency cases dropped by 14.4 per cent to 4,092 cases. The regions of Catalonia, Madrid and Valencia still account for 60 per cent of the total cases. Most of these insolvencies correspond to microbusinesses and retail, real estate services, construction and leisure were the sectors most severely affected.

We expected that covid-19 would have increased dramatically such figures during 2020–2021. However, the measures enacted by the Spanish government to protect and financially assist debtors during this crisis aimed, among other things, to avoid insolvency proceedings by suspending the debtor's duty to file insolvency and the creditors' rights for petition, initially until 31 December 2020. This term was again extended until 31 December 2021 by Royal Decree-law 5/2021, of 12 March. Therefore, most insolvency cases and dissolution processes will be moved into 2022 . In fact, the beginning of 2021 already showed a significant increase of insolvency proceedings compared to 2020. For the period January to April 2021, there were 2,114 *concursos* (and increase of 72 per cent in comparison to 2020) evidencing the impact of covid-19 and the lack of liquidity, despite the insolvency moratorium still in force. Retail, leisure and services continue to be the most affected sectors in 2021.

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 entered into 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.[2]

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Introduction to the insolvency regime

The SIA was amended (by the TRLC) in 2020. 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.

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.

2 See https://www.publicidadconcursal.es/concursal-web/.

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 (see below for the special rules related to covid-19). 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-insolvency 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)

Pursuant to the SIA, 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.

Given the absence of specific regulation in the SIA, some Spanish courts (i.e., those of Madrid, Barcelona and the Balearic Islands) have elaborated a protocol envisaging the 'pre-pack sale' of business units. Although these rules are not binding and are not homogeneous, these protocols aim to commence the process of sale of the business unit before the insolvency declaration. The goal is to expedite the sale process much as possible, while ensuring that, in the case of direct sales, there has been sufficient market prospection and sharing of information with interested parties to maximise the business unit proceeds.

For instance, the protocol approved by the Barcelona courts envisaged the appointment of a temporary insolvency administrator following the pre-insolvency notice filed by the debtor. The temporary insolvency administrator must monitor the sale process conducted during the pre-insolvency process. Once a bidder is selected, the debtor files for insolvency together with the binding offer to acquire the business unit. The temporary insolvency administrator (who will later become the formal insolvency administrator upon the insolvency declaration) will issue a report stating that the binding offer was the best offer in the competitive sale process and request the competent court to conduct a direct sale sale (i.e., without conducting a public auction enabling other potential offerors to submit alternative bids) of the business unit to the winning bidder at an early stage of the insolvency proceeding. The court will then swiftly authorise the transaction.

While sharing the same goals of maximising the business unit proceeds for the benefit of creditors and expedite prompt sales upon insolvency declaration, the guidelines do not align. In contrast to the Barcelona courts, the Madrid courts will not appoint an insolvency administrator prior to an insolvency declaration.

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: be supported by a viability plan allowing the continuity of the business activity in the short and medium term;

a involve a significant increase of available credit, or the amendment of existing obligations (either through rollover or maturity extension); and

b 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 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.

Pledges over shares and credit rights could be granted according to Royal Decree 5/2005, which implemented the EU Directive on financial collaterals in Spain. As a result, such security could be enforced through straightforward proceedings and would be ring-fenced against any stay under the SIA.

Lastly, some Spanish autonomous regions, in particular Catalonia, have approved local regulation of 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 ability to enforce 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. The fiduciary duties are always owed to the company irrespective of who the residual claimants are (shareholders or creditors). 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.

Law 3/2020, of 18 September, amended by Royal Decree-Law 5/2021 of 12 March, mainly provides that:

a insolvent debtors' obligation to file for insolvency has been suspended until 31 December 2021. During this period, creditors' petitions for the declaration of involuntary (mandatory) insolvency will also be suspended;

b composition agreements can be amended and extended until 21 December 2021;

c suspension of the duty to file for liquidation in case of breach of the composition agreement or renovated insolvency until 31 December 2021; or

d 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 of 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) will not be subordinated, but rather considered unsecured claims.

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 Nueva Pescanova

The court upheld the challenge brought by several funds represented by Cuatrecasas that contended that the majority thresholds for cramming in holdouts had not been achieved because the votes casted by the connected parties could not be counted. For the very first time, a Spanish court ruled in favour of the dissenting creditors and annulled the initial court approval of the refinancing agreement.

The ruling, which establishes an important precedent in Spain, includes a new interpretation of what is considered an insider within a pre-insolvency scenario.

According to the judgment, strict limitations should be imposed on insiders in a pre-insolvency scenario to prevent companies holding a major stake in the distressed company (or with decision-making capacity over it) from deciding on the conditions of the refinancing agreement and imposing them on the other creditors. Otherwise, they would be acting in clear conflict of interest. Despite Nueva Pescanova's shareholders' arguments, the court upheld Cuatrecasas' arguments and ruled that that the claims held by the Nueva Pescanova's main shareholder could not be counted for threshold purposes given that the majority shareholder (1) based on the evidence filed within the proceedings, was considered as a de facto director of the debtor given that it had decisive influence on the legal directors of the company; (2) was part of the same group of the debtor (being the shareholder of the parent company of the group); and (3) owned more than 10 per cent of the share capital of the debtor and regardless of the date of strict origination of the claim in the event of derivative acquisitions.

ii Elsamex: business unit sale + restructuring agreement

In 2020, the financial creditors of Elsamex were negotiating with the board a restructuring agreement. Given the board of directors and sole shareholder's lack of traction in reaching a restructuring agreement ensuring the continuity of the business, a financial creditor ended up requesting Elsamex's insolvency declaration. Upon the insolvency declaration, Cuatrecasas advised a pool of financial creditors in the insolvency proceeding and analysed potential alternatives to save the business, as the liquidation of Elsamex would have brought very low recovery expectations for our clients. The syndicate pool decided to support a business unit offer submitted by Elsamex's management team aimed at acquiring the viable business unit while leaving behind those non-viable business units (the EPC branch). To this end, the management team created a newco that acquired (by means of a capital increase subscribed by Elsamex's insolvency officer) most of the Elsamex's assets. The offer was cashless, as the consideration consisted of the assumption of all the liabilities linked to the acquired viable business unit. The offer was supported by Elsamex's insolvency administrator and approved by the insolvency court.

This transaction was novel in the Spanish market as the business unit offer already envisaged that the assumed financial debt would be subsequently restructured following closing of the business unit acquisition. Such restructuring agreement (which included granting of *ex novo* security interest) was homologated and holdouts were crammed in to be bound by the terms of the agreed restructuring agreement.

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 entered 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.

ÍÑIGO 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 partner 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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