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Key issues of Spanish insolvency reform

Main new developments regarding pre-insolvency, the sale of business units, insolvency proceedings and ICO-backed debt refinancing

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The approval of the insolvency reform completely overhauls the Spanish insolvency and pre-insolvency system.

In terms of pre-insolvency, it affords new debt restructuring opportunities, giving a more prominent role to creditors, who will be able to benefit from pre-insolvency instruments providing greater speed and flexibility, and offering a greater scope, as they allow the possibility of cramming down all classes of creditors, including the debtor’s shareholders.

The reform lays down detailed provisions on preparing, in the pre-insolvency stage, the sale of business units whereby the court appoints an independent expert responsible for collecting potential purchase offers (known as “pre-pack”).

It also introduces significant new developments concerning insolvency proceedings, including the removal of advance composition proposals and the acceptance of non-detrimental subordination agreements during the liquidation stage.

It completes the procedure for ICO-backed debt refinancing.

1. Approval of the insolvency reform

Following the few amendments to the bill introduced by the Senate on July 20, 2022, the Spanish Congress must hold a plenary session to definitively approve the draft bill amending the Insolvency Act to incorporate the Directive on Preventive Restructuring (the "**Reform**"), which is expected to occur in the following weeks.

The Reform will bring about a complete overhaul of the Spanish insolvency system, particularly with regard to pre-insolvency instruments.

The Reform will enter into force 20 days after its publication in the Official Gazette of the Spanish State (we expect this to happen in September). Once it has entered into force, the new act will apply to notices of the opening of negotiations with creditors, restructuring plans under negotiation and requests for the court sanction of restructuring plans and applications for insolvency.

Below we summarize the main new developments affecting:

- the pre-insolvency system and pre-insolvency instruments (particularly, **new restructuring plans**) detailing the main impacts on creditors, shareholders and debtor's directors;
- the **debtor's sale of business units** (particularly, the so-called pre-packaged insolvency process or "pre-pack");
- the insolvency proceedings system; and
- the regulation of transactions involving debt refinancing guaranteed by the Spanish State Finance Agency (Instituto Oficial de Crédito or "ICO") (included during parliamentary processing).

We refer only to Spanish public and private limited companies that are not considered SMEs (i.e., those with an annual turnover of at least EUR 10 million and at least 50 employees). The system applicable to SMEs imposes other rules that must be taken into account if applicable.

Likewise, the Reform establishes a special procedure for micro-enterprises (those with fewer than 10 employees and less than €700,000 annual turnover or €350,000 in liabilities), in which creditors play a more decisive role, which we will not focus on in this newsletter. This special procedure is regulated in new Book III of the Insolvency Act and will enter into force on January 1, 2023.

2. New developments regarding pre-insolvency instruments

Restructuring plans

Book II of the Insolvency Act, entitled "pre-insolvency law," has been amended completely.

The purpose of the restructuring plans, which will replace refinancing agreements, may be to change the conditions or structure of the debtor's assets and liabilities, or its equity. The plans may also involve the transfer of assets, business units or of the whole company.

The entry into force of the Reform will afford **new debt restructuring opportunities** giving a more prominent role to creditors, who will be able to benefit from pre-insolvency instruments providing greater speed and flexibility, and offering a greater scope, as they allow the possibility of cramming down all types of creditors (financial, commercial and even holders of public law credits that meet certain requirements) and shareholders of insolvent companies.

To facilitate debt restructuring at an earlier stage, the Reform allows notifying the competent court that negotiations have been opened with creditors or that the negotiation and signature of the restructuring plan has been carried out when the debtor's circumstances indicate a "**likelihood of insolvency**," that is, when it is objectively foreseeable that if a restructuring plan is not agreed, the company will be unable to regularly meet its obligations falling due in the following two years. Also, it will still be possible to seek a pre-insolvency solution in cases of imminent insolvency, which has been redefined as the foreseeable inability to meet obligations falling due in the following three months. Current insolvency is still considered to be a financial state in which it is possible to seek a pre-insolvency solution.

As discussed below, how the debtor's financial state is qualified is vital when it comes to negotiating the restructuring plan and imposing the plan on the shareholders.

In terms of pre-insolvency, the new system includes new developments that greatly affect creditors, shareholders and directors of limited companies in a situation of pre-insolvency. We summarize the main points below, focusing first on the impact on creditors, and then on shareholders and directors. We will set out these developments following the chronological order common to the negotiation of most restructuring plans:

- Start of negotiations and notice to the competent court that negotiations have been opened
- Negotiation of the restructuring plan between the creditors and the debtor's governing body
- Approval by the debtor's partners meeting, if required, of the measures affecting the shareholders' rights
- Court sanction

Restructuring plans: main new developments for creditors

Notice of the opening of negotiations: suspension of foreclosures and applications for mandatory insolvency

With a scope similar to the previous system, the debtor is still entitled to notify the competent court that it has entered into negotiations with its creditors to reach a restructuring agreement. The effects of that notice can last for up to three months with the possibility of requesting a three-month extension (if certain requirements are met). This notice is crucial for the role creditors play, as it enables the temporary suspension of individual, judicial or out-of-court enforcement over the assets required for the debtor to continue its business activity, as well as the start of new enforcements and the enforcement of securities *in rem*.

The notice alone will not affect agreements establishing reciprocal obligations pending fulfillment, and any contractual clauses stating otherwise will be considered void. Also, early termination of these agreements on the grounds of the debtor's previous non-compliance will also be suspended, as long as the agreements are necessary to ensure the continuity of the business activity.

Moreover, creditors will not be able to file for mandatory insolvency proceedings while the notice period regarding negotiations is in force, which is complemented with new provisions on the temporary suspension of petitions of insolvency filed by the debtor and the legal obligation to agree to dissolution due to qualifying losses, as explained below.

Affected credits

One difference with the previsions on refinancing agreements under the previous system is that restructuring plans may have an impact on all kinds of creditors and credits, with very few exceptions, and all affected parties are entitled to participate in the approval of the plan. This means that financial and commercial creditors may be affected, including contingent credits and those subject to conditions, in which case special calculation rules apply. Public law credits will also be subject to conditions and restrictions with regard to the effects that can be imposed.

In contrast, credits for non-contractual civil obligations and labor credits will not be affected unless they involve senior management contracts, which may be affected if so required for the restructuring to be successful.

Formation of credit classes

One of the main aspects for new restructuring plans to be successful is the formation of credit classes, as this will be decisive for the approval of the plan and for establishing its content.

The criteria for class formation are relatively open, despite there being some imperative rules that must be observed at all times. Specifically, one mandatory general rule is that credit classes must always be formed on the basis of a joint interest of credits belonging to the same class. The guiding principle behind that joint interest is the rating established in the insolvency classification of credits, so that credits belonging to the same class have the same insolvency rating. Also, credits with securities in rem will make up an individual class and public law credits will make up a separate class within their respective insolvency rating.

However it is possible to separate credits belonging to the same insolvency rating into different classes when different joint interests exist within the same rating, in view of the open criteria (e.g., how the credit is affected, different guarantees, different credit nature).

The debtor company or majority of creditors potentially affected by the restructuring plan may request judicial confirmation regarding the adequacy of class formation before requesting the court sanction of the restructuring plan, thus exhausting the possibility of opposing or bringing a challenge on these grounds if the class is confirmed.

Approval of the plan by creditor classes

The plan is voted on by the different credit classes. Approval of the plan requires the favorable vote of two-thirds of the class liabilities, or three-quarters if it is a class of credits with securities *in rem*.

The court sanction of the plan can be obtained with different levels of consensus by the creditor classes. The approval of the debtor is also required in certain circumstances, as explained below. Thus, first of all, the plan will be validated if it is approved by all of the creditor classes. Failing that, the sanction will depend on the approval of a majority of the formed classes, as long as at least one class of those voting in favor is a class with a privileged insolvency rating. And, failing that, it may be validated if it has been approved by at least one class that is "in the money."

Court sanction and cramdown effects on creditors

For the restructuring plan to be court-sanctioned, as well as the requirements of content, form and approval by the credit classes and, if applicable, by the debtor, it must offer a reasonable prospect of avoiding insolvency, ensure the debtor's viability in the short and mid-term, and treat creditors of the same class equally. Other requirements have been determined as grounds for challenge and would eventually be monitored if a challenge is presented.

The court sanction of the restructuring plan can extend its effects to all credits affected by the plan. As a result of the Reform, there is a much greater possibility of extending the effects of a restructuring plan to dissenting creditors within the same category, and this extension of effects also applies to whole categories of creditors, even those in higher ranks.

Agreements establishing reciprocal obligations pending fulfillment. Contracts entered into with executive directors and senior management staff

Agreements establishing reciprocal obligations that the debtor has entered into will remain in force. Thus, the request for the court sanction of the restructuring plan, its admission to processing, and, logically, the court sanction itself will not affect these agreements, and any contractual clauses stating otherwise or allowing the parties to change this rule will be considered void. The Reform lays down the same rule regarding the notice that negotiations have been opened with creditors.

However, it introduces the possibility for the restructuring plan to terminate these agreements for the benefit of the restructuring, as long as the debtor has previously asked the other party's consent to amend the contractual terms or terminate the agreement. The affected contractual party can challenge the termination of the agreement, claiming that it is not necessary for the restructuring to be successful, and it can claim compensation for the early termination of the agreement. Compensation resulting from termination may be subject to the plan.

Likewise, it specifically allows the suspension or termination of contracts entered into with executive directors and senior management staff if so required for the restructuring to be successful. Any resulting compensation can be modified by the judge in charge of the court sanction, overruling any amount determined to that effect in the agreement.

Protection in cases of later insolvency: particularly, new money and interim financing

If insolvency is declared after a plan is court sanctioned, the Reform grants protection against clawback actions of acts carried out in the context of promoting or implementing the plan. Specifically, it protects transactions necessary for the negotiation of the plan to be successful, transactions necessary to implement the plan, and interim financing and new money, that is, financing granted during the negotiation of the restructuring plan to ensure above all the continuity of the business activity, or the financing described in the plan that is necessary for it to be successful, respectively.

As well as protection against clawback actions, interim financing and new money could be given preference for payment under certain conditions.

Both types of protection are also provided for in cases where interim financing and new money have been granted by persons closely related to the debtor company, although stricter requirements must be met.

Challenge of the court sanction by creditors

Dissenting creditors can oppose the court sanction of the restructuring plan through two mutually exclusive channels: before the court sanction, if the party requesting the court sanction presents a previous challenge stating the opposition of the affected parties to the same competent legal authority; or by challenging a confirmed court sanction before a higher court (court of appeals). The grounds and legal basis are the same, but they will depend on whether the plan has been approved by all creditor classes. There will be fewer grounds for challenge or opposition of plans approved by all classes.

With regard to substantive grounds for opposition or challenge, one of the grounds to challenge any restructuring plan is based on the **best interest of creditors rule**, which allows dissenting creditors to file a challenge if they would have received more in hypothetical insolvency liquidation proceedings carried out two years after formalizing the plan.

In the case of opposing or challenging plans that have not been approved by all classes, the most noteworthy involves the infringement of rules that seek equity in the solution provided in the plan, i.e., equal treatment among classes belonging to the same rank, the prohibition on granting one or several classes an amount or rights that exceed the value of their credits, and the prohibition on granting a lower-ranking class, or the shareholders, any amount or rights when the higher-ranking class to which the challenging party belongs has not been paid all of its credits (**absolute priority rule**). Exceptions will apply to the fulfillment of this rule if it is essential for the company's viability and damage to the affected credits is not unjustified.

The challenge will only render the plan ineffective if the grounds for the challenge are an insufficient majority or the inadequate formation of credit classes. Otherwise, the dissenting creditors will be released from any effects under the restructuring plan. If the effects cannot be reversed, they will be entitled to compensation for damages payable by the debtor.

Restructuring plans: main new developments for shareholders and directors

For shareholders, the reform will mean a paradigm shift given that, if certain conditions are met, creditors may be able to impose a restructuring plan on them. In short, the new system subjects the plan to the shareholders' approval when it contains measures that require their agreement, although it sets out special rules to favor approval. In a situation of current or imminent insolvency, the plan can be sanctioned even against the shareholders' will, although this does not rule out the possibility of challenging it.

In the case of directors, the Reform does not impose a specific legal regime on the pattern of conduct they should follow in a pre-insolvency situation (as proposed in the Pre-insolvency Directive), as the Reform considers that it is implicit in the regulations on their duty of diligence, in the rules on compulsory dissolution due to serious losses, and in the insolvency liability regime.

Notice of the opening of negotiations: suspension of the legal duty to seek wind-up and suspension of the request for voluntary insolvency proceedings

The reform lays down detailed provisions on notifying the competent court of the opening of negotiations with creditors to establish a restructuring plan. Notice must be given by the debtor's governing body and it enables the temporary suspension of individual, judicial or out-of-court enforcement over the assets required for the debtor to continue its business activity during the negotiation of the restructuring plan, among other measures designed to safeguard the company's activity.

The reform introduces two important developments affecting the debtor's directors regarding this notice:

- First, the effects of the notice are extended to the legal duty to seek wind-up due to losses provided under corporate law, coordinating insolvency and corporate regulations. Thus, it is clarified that, while the effects of the notice are in force, **the legal duty to seek wind-up owing to serious losses** will be suspended in cases where the company's equity is reduced to an amount lower than half of the share capital. This makes pre-insolvency regulations consistent with corporate law and significantly affects the debtor's directors,

who, during that period, will not have joint and several liability provided under corporate law for the company's debts.

- Second, at the creditors' or the restructuring expert's request, the judge can suspend the application for voluntary insolvency proceedings of a debtor if it is negotiating a restructuring plan and it can be proved that the plan is likely to be approved. This means that the debtor no longer has an instrument that, in practice, was sometimes used by its directors to force negotiations in more favorable circumstances.

Approval of the plan by the general meeting of shareholders

If the restructuring plan incorporates measures that, under the general rules of corporate law, must be decided by the general meeting of shareholders (e.g., the transfer of essential assets, debt for equity swaps, mergers and spin-offs), the plan will require the **approval of the debtor's general meeting of shareholders**.

To facilitate the process and the approval of the plan, the Reform introduces **special rules on calling meetings and on majorities** for the agreement to be adopted by the debtor's general meeting:

- It establishes a reduced period to call the meeting (10 days for public and private limited companies, and 21 days for listed companies).
- The only item on the agenda will be the approval or rejection of the restructuring plan on all points.
- The shareholders' right to information will be restricted to this single item.
- The resolution will be adopted, regardless of its content, following the ordinary legal quorum and majority rules. Neither the legal reinforced majorities nor those established in the debtor's bylaws will apply.

Corporate transactions included in the plan will be governed by the rules applicable to them, except the abovementioned rules on the adoption of resolutions at the general meeting. Also, the Reform disallows the preferential subscription right of the debtor's shareholders when it comes to capital increases laid down in the plan (including what is known as a *coup d'accordion*, i.e., reducing the share capital to zero or to below the legal minimum with a simultaneous capital increase), if the debtor is in a situation of imminent insolvency or current insolvency.

Corporate measures to protect creditors adopted for these transactions are also inapplicable, particularly the right of creditors affected by the plan to challenge structural modifications, as they will be replaced by the pre-insolvency protection rules.

The agreement of the general meeting approving the restructuring plan can be challenged in accordance with corporate law, but only using the channels and within the periods provided under insolvency law to oppose or challenge a court sanction.

Debt for equity swaps

Debt for equity swaps are likely to be a key element in restructuring plans. To facilitate these transactions, in the case of credits being converted into the debtor's shares, the credits will be considered fully liquid, due and payable, thus meeting the requirements imposed under corporate law. As mentioned above, shareholders cannot exercise preferential subscription rights even in situations of reduction of the share capital to zero and simultaneous increase made through credits set-offs if the debtor is in a situation of imminent insolvency or current insolvency.

Also, if the debt for equity swap triggers the debtor's change of corporate control, the contractual clauses on change of control that the debtor may have agreed to in agreements necessary to continue its business activity will not apply.

Court sanction and cramdown effects on shareholders

The court sanction of the restructuring plan can extend its effects to all of the debtor's shareholders. As pointed out above, shareholders attending the debtor's general meeting must vote on the plan when it includes measures falling within the scope of its powers. However, although the Reform acknowledges shareholders' voting rights, in certain cases it is possible to sanction the plan against their will and extend the effects to dissenting shareholders.

Thus, in a situation of likelihood of insolvency, and if the plan includes measures falling within the scope of the general meeting's powers, the court sanction will require an agreement from the general meeting to approve the plan. In this case, any dissenting shareholders will be crammed down by the majority principle, in the same way as other corporate resolutions. If the plan does not contain measures falling within the scope of the general meeting's powers, approval will be given by the debtor's governing body.

In a situation of imminent insolvency or current insolvency, the court sanction is not subject to the debtor's approval of the restructuring plan. If the shareholders attending the general meeting vote against the plan, this will not prevent the sanction and the effects of the plan from subsequently being extended to all of the shareholders and the debtor. Naturally, if the general meeting approves the plan, the effects will be extended to dissenting shareholders owing to the majority principle. If the plan does not contain measures falling within the scope of the general meeting's powers, whether it is approved or rejected by the governing body will not affect whether the court sanction is successful or the extension of its effects.

Any corporate transactions envisaged in the court sanctioned plan must be carried out according to the procedure set out under corporate law. However, if it is necessary for the debtor's general meeting to authorize those transactions and it has not given its approval, the company directors will have the powers to carry out any actions required to implement the plan and to make any necessary changes to the bylaws. If the directors fail to do so, the judge can grant powers to another person to carry out these actions. The court order sanctioning the plan will be sufficient to register the bylaw amendments established in the plan in the commercial registry, in accordance with the rules governing it.

Challenge of the court sanction by shareholders

It is also envisaged that, if certain circumstances are met, the debtor's shareholders can challenge the court sanction of the restructuring plan.

If the shareholders' challenge against the court sanction is successful, the effects will not be extended to the challenging parties, but will remain valid against the others. However, if the effects cannot be reversed, the challenging shareholder will be entitled to compensation for damages.

If the debtor's general meeting approves the plan, the shareholders cannot challenge the court sanction. The resolution of the general meeting approving the plan could still be challenged.

Directors' duties in pre-insolvency situations

Under the Reform, as under the current system, the debtor will still have management and administration powers over the company's assets while a pre-insolvency solution is being sought, even if a restructuring expert is appointed.

The Spanish lawmaker does not consider it necessary for insolvency law to include a specific regime on the duties of the debtor's directors in pre-insolvency situations, as they are already implicit under applicable law. If companies face the risk of insolvency, their directors, acting with the duty of diligence required of them, must adopt measures to avoid that insolvency or mitigate any harmful consequences. In exercising their functions and fulfilling their duties, the debtor's directors have the necessary powers to open negotiations with creditors, submit the notice of the opening of negotiations to the judge, and ask the court to sanction the restructuring plan.

3. Developments regarding the sale of business units

Regarding the debtor's sale of business units as well as the possibility, at the pre-insolvency stage, of including the sale as part of the restructuring plan itself, the transfer of the company or its business units may occur at three times during the insolvency proceedings: (i) on submitting the request for opening special wind-up proceedings; (ii) during the liquidation stage; or (iii) through a downstream bid, without making it conditional on the opening of the liquidation stage. Even before filing a request for insolvency proceedings, debtors whose circumstances indicate a likelihood of insolvency or who are in a situation of imminent insolvency or current insolvency may request the court to appoint an independent expert responsible for collecting offers for the purchase of business units (pre-pack).

Despite there being no specific rules under Spanish law on the pre-pack process, to facilitate these procedures, judges of the commercial courts (particularly those of Barcelona and Madrid) had already approved certain protocols and applied them in recent months to speed up the sale process of the business units, avoid the deterioration in economic activity and maximize the recovery of creditors. The Reform now establishes a specific procedure to be followed.

Below is a brief explanation of the sale of business units as part of a restructuring plan and during insolvency proceedings, largely focusing on the pre-pack system.

Sale of business units on implementing restructuring plans

As mentioned above, the Reform enables restructuring plans to include the transfer of assets, business units or of the whole company, although it does not provide any details with regard to the system or enforcement procedure.

The sale of business units set out in a restructuring plan will be subject to the restructuring plan system mentioned above (particularly, protection against clawback actions in cases of later insolvency). Otherwise, transfers will be subject to the general commercial law system for business sales, particularly for the purposes of labor and social security succession, taking on tax liabilities arising from operating the business and the need to seek the consent of the counterparties to agreements transferred as part of the business unit.

Sale of business units in insolvency proceedings. Pre-pack process

The main development of the Reform as regards debtors' sale of business units during the insolvency proceedings is the detailed regulation on the pre-packaged

insolvency or pre-pack process to prepare an application for insolvency proceedings, submitting an offer to purchase one or several business units with the help of an expert appointed by the court hearing the proceedings.

No changes are made to the system in force in relation to the minimum content of offers to purchase business units (offeror's identity and solvency; precise description of assets, rights, agreements and licenses or permits included in the offer; price, payment arrangements, and price guarantees and details of the different price offered in case any encumbrances over the assets and rights transferred continue to apply; and how the offer will affect workers); and the effects of the purchase for the acquirer (in brief, the selection of agreements by the offeror and the automatic subrogation of contracts without the need for the counterparty's consent—except administrative contracts which will be governed by rules on public sector contracts; subrogation of administrative licenses and permits making up the business unit; and the non-assumption of insolvency liabilities, except labor and social security debts of the workers taken on).

The same rule on the existence of business succession will continue to apply for labor and social security purposes on transferring business units at any stage of the insolvency proceedings. The biggest development is that the Reform resolves doubts about jurisdiction, resolving that only the commercial courts will be able to hear those cases. This means that these courts will be the only ones competent to declare the existence of labor and social security succession and to identify the workers affected by the sale of the business unit, for which they may request a report from the Labor Inspectorate. Regarding this second matter, another act is under consideration at the same time that would amend article 86ter of the Spanish Judicial Power Act regarding the jurisdiction of insolvency judges.

Pre-pack system

As explained above, the Reform lays down detailed provisions on preparing, in the pre-insolvency stage, the sale of business units by means of the so-called pre-pack process to facilitate the sale of business units by debtors whose circumstances indicate a likelihood of insolvency or that are in a situation of imminent insolvency or current insolvency at the time the proceedings begin.

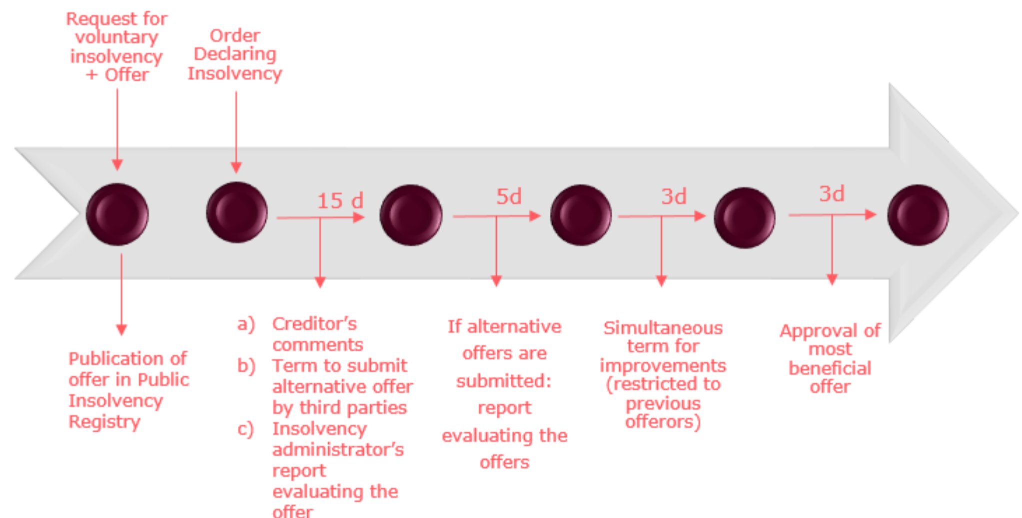
The main features of this regulation are described below.

- **System to evaluate offers at the debtor's request, for which it may ask for an expert's help**. Debtors whose circumstances indicate a likelihood of insolvency or that are in a situation of imminent insolvency or current insolvency may request the court which will hear the proceedings to appoint an expert responsible for collecting offers for the purchase of one or several businesses units before filing for insolvency. On declaring insolvency, the judge may confirm or revoke the appointment of the expert. If ratified, the expert will become insolvency administrator.

- **Filing for insolvency with the submission of a binding offer**. On filing for insolvency proceedings, the debtor company will also submit a written binding offer from a creditor or third party to purchase one or several businesses units.

- **Commitment to maintain the activity**. The offeror must take on the commitment to continue or restart the activity with the business unit or units referred to in the offer for at least two years. The breach of this commitment will entitle any affected party to claim compensation from the acquirer for any damages caused.

- **Regulated process**. After the debtor has filed for insolvency proceedings and submitted the binding offer, the judge will follow the process in accordance with the law so that the creditors may make themselves known and any interested party can submit an alternative binding offer (including company workers), as set out in the diagram below:



- **Selection of offers**. If several offers are submitted, the judge will select the one that most benefits the proceedings. If the workers submit an offer that is equal to or higher than the offers submitted by other parties, the judge will give priority to the workers' offer as long as it is to the benefit of the insolvency, considering, among other criteria, the continuity of the company, the business unit and the job positions.

4. Other developments concerning insolvency proceedings

Main developments concerning the reform of Book I on insolvency proceedings

General aspects

Below is a summary of the most significant developments implemented under the Reform that concern Book I of the Insolvency Act:

- **Insolvency without estate**. These procedure is regulated for cases in which the insolvent party has no attachable assets or rights, the cost of the proceedings would be disproportionate to the foreseeable market value, the value of the assets free of charges is lower than the expected costs of the proceedings, or when the amount of the existing charges and encumbrances is higher than the market value.

- **Insolvency administration**. The remuneration system has been amended, and appointments are made correlatively according to the expected complexity of the insolvency proceedings and not their size.

- **Insolvency estate**. The Reform modifies the prohibition to sell assets and rights of the insolvency estate, which is now extended until an agreement is approved or the liquidation stage begins (previously, the approval of the liquidation plan was required).

- **Clawback actions**. Clawback may apply to (i) actions carried out during the two years before the date on which the debtor files for insolvency proceedings (instead of the date of declaration of insolvency) and to actions carried out between the filing date and the declaration date; and (ii) actions carried out in the two years before the date on which notice is served informing of the intention to open negotiations or the existence of negotiations to draw up a restructuring plan, or actions carried out between that date and the date of declaration of insolvency, as long as a restructuring plan has not been approved and, if it has, that it has not been sanctioned by the court and the insolvency has been declared within one year following the term of the notice or its renewal period.

Composition agreement

Below are the most noteworthy aspects of the composition agreement stage:

- The Reform removes all articles referring to advance composition proposals.

- It regulates composition **proposals including structural modifications** (mergers, spin-offs, assignment of all assets and liabilities) in which insolvency creditors will have no right to challenge structural modifications. These transactions cannot result in the creation of a new company, an absorbing company, one benefiting from the spin-off or an assignee with negative net equity as a result of the modification.

- Also, if the agreement includes a **debt for equity swap**, the general shareholders meeting will not be required to approve a capital increase agreement, as the administrators or the board will have this power, the shareholders' preferential subscription right is excluded, and the new shares issued or created can be freely transferred for 10 years from the date the capital increase is registered with the commercial registry.

- As regards **public law credits** or **labor credits**, composition proposals cannot cause changes to applicable law, a change of debtor, the modification or termination of guarantees or a conversion of debt into shares, participating loan agreements, or other credits with characteristics or a rank different to those of the original credit. Neither can they lead to the write-off or deferral of certain social security contributions.

- The insolvent party may submit the composition proposal at the same time as it files for insolvency or at any later time, as long as less than fifteen days have elapsed since the submission of the insolvency administration's report.

- A modification proposal may be submitted after two years of validity with regard to the agreement that is at risk of non-compliance when this is necessary to ensure the company's viability.

- Actions can be voided if they are harmful to the debtor's assets and were performed within two years before the application for non-performance of the composition agreement or, when it cannot be fulfilled, once the liquidation stage begins.

Liquidation, categorization of the insolvency and completion of the proceedings

We highlight the following noteworthy aspects regarding the liquidation of the insolvency estate, the insolvency categorization and the completion of the proceedings:

- Any credits the debtor may have taken out while fulfilling the composition agreement will be considered insolvency claims.

- The liquidation plan is no longer obligatory and the liquidation will be carried out in accordance with the special rules imposed by the judge or, failing that, general liquidation rules.

- **Relative subordination agreements between creditors** will be acknowledged and enforced during the proceedings and the insolvency administrators will respect them when making the payments as long as that are not detrimental to third parties and the debtor is a party to the agreement.

- The start of the categorization of the insolvency process will be determined by the judge in the order closing the common stage.

- Creditors who are part of the proceedings can deliver to the judge any arguments they consider appropriate for the declaration of the insolvency to be presumed culpable and submit a reasoned report with a proposal for the declaration of the insolvency to be declared culpable when they make up at least 5% of the insolvency liabilities or they hold credits for an amount exceeding €1 million.

- Grounds to conclude the insolvency proceedings now include the merger, takeover or spin-off of the insolvent company, as well as the assignment of all assets and liabilities, in cases permitted by law.

5. New developments regarding ICO-backed refinancing

The Reform also regulates the pre-insolvency and insolvency system of the facilities granted by the Spanish state through the ICO under Royal Decree-laws 8/2020, 25/2020 and 6/2022, on urgent extraordinary measures to face the COVID-19 pandemic and the war in Ukraine. These issues had been regulated under Royal Decree-Law 5/2021, implemented by the Resolution of the Council of Ministers of May 11, 2021. The Reform includes these rules and complements them.

The main developments are described below:

- **Regime for recovery and collection.** The Reform refers to the system provided under article 16 of Royal Decree-law 5/2021, implemented by the Council of Ministers' resolution of May 11, 2021, and later resolutions amending the latter.

- **Nature of credits.** Credits arising from public guarantees will be considered financial credits for all purposes provided under the Insolvency Act, including class formation.

- **Credit rank.** Credits arising from public guarantees will be ranked as ordinary credits, without prejudice to the existence of another form of security granted to the main guaranteed credit, which will have at least the same rank in the order of precedence as the principal that is not guaranteed.

- **Representation**. Financial institutions will be responsible for state representation in insolvency proceedings regarding credits arising from public guarantees. They will be in charge of sending notices, exercising voting rights and filing any necessary claims for the acknowledgment and payment of credits arising from the guarantees.

- **Contents of restructuring plans, continuity plans and composition proposals** affecting credits arising from public guarantees cannot impose certain rules (they cannot cause changes to applicable law, a change of debtor, the modification or termination of guarantees or a conversion of debt into capital or participating loan agreements, or other credits with characteristics or a rank different to those of the original credit or loan).

- In **restructuring plans**, for the financial institution to be able to vote in the name and on behalf of the General State Administration in favor of deferrals, installments or write-downs, it must seek authorization from the collections department of the Spanish tax authorities. Failure to do so could result in the loss of the guarantee for the part that has not been enforced or, otherwise, the

state holding the rights for recovery and collection, without being affected by the contents of the plan.

- In the case of **continuity plans and composition proposals**, the bodies of the Spanish tax authorities will have the power to approve the corresponding vote, and the vote will be cast by the state legal advisors.
- **Subrogation**. The declaration of insolvency will cause the subrogation of the General State Administration (Ministry of Economic Affairs and Digital Transformation) corresponding to the part of the principal that is guaranteed, regardless of whether the guarantee has been enforced, thus acting as insolvency holder of the credit. In any case, the pertinent financial institution will continue representing the financial transaction as a whole.

Our Restructuring, Insolvency and Special Situations practice

A specialized and multidisciplinary team, recognized for its expertise in innovative and strategic solutions for special situations and crises

We offer comprehensive advice on managing crises, providing solutions to the different legal problems faced by companies, investors and creditors.

We are recognized on the market as one of the main experts for advising on special situations and crises. Our clients include financial institutions, bondholders, investors, investment and venture capital funds, and hedge funds, as well as directors, senior managers and shareholders.

Thanks to our specialty in this area, and the experience of our lawyers and our network of international offices, we have participated in some of the most sophisticated and high-profile restructuring processes in Spain, Portugal, London, New York and Latin America in recent years, advising large multinationals on debt restructuring and insolvency proceedings, as well as advising major financial institutions.

"Consistently shown not only a deep understanding of the legal aspects of the situation but are also able to understand the commercial strategy." Chambers, 2022

"Pragmatic and constructive in negotiations." Chambers, 2021

Local approach

Most of our offices in Iberia have lawyers specialized in debt restructuring and insolvency procedures, enabling us to provide a local approach to clients in trouble.

High-profile clients and cases

We have advised some of the most relevant Iberian companies on their debt-restructuring and insolvency procedures, as well as their creditors, mainly important banks. Our lawyers have participated in some of the most sophisticated and high-profile restructuring and insolvency proceedings in Spain and Portugal in recent years.

Distressed assets experience

Our lawyers have extensive experience advising in insolvency proceedings. We also advise companies on selling their business units and potential investors on acquiring them.

Leading practice

Our practice is one of the most renowned in the market. This leading position is reflected in different legal directories, including Chambers, Legal 500 and IFLR, where we have been consistently ranked first for many years.

Leading firm – Tier 1 in Restructuring and Insolvency

Firm recognized as one of the main law firms in Restructuring and Insolvency category, 2021

Law firm of the year in Restructuring and Insolvency in Spain

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For additional information, please contact our *Knowledge and Innovation Group* lawyers or your regular contact person at Cuatrecasas.

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