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Analysis of the insolvency measures introduced by Royal Decree-law 16/2020, of 28 April, on procedural and organisational measures to deal with Covid-19 in the field of Administration of Justice

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I. Introduction

Yesterday was published the Royal Decree-law 16/2020, approved in the Cabinet meeting.

This new Royal Decree-law responds to the Government's objective of, essentially and on the one hand, trying to avoid overloading of the courts once the 'state of alarm' has been lifted, due to the foreseeable increase in litigation - also ensuring that the increase in judicial activity does not trigger the risk of new contagion - and, on the other hand, providing financially distressed debtors with tools to overcome the economic crisis that is already going hand-in-hand with the health crisis.

Before delving into the specific content of Royal Decree-law 16/2020, it should be noted that the Government seems to have almost completely dispensed with the many proposals put forward by the General Council of the Judiciary in its "contingency plan", to prevent the collapse of Justice after the end of the state of alarm; unless the said Royal Decree-law is followed by others that

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follow such recommendations. In fact, the measures suggested by the General Council are not included in this document - no doubt rightly, since they exceeded the limits of the urgency required to use this legislative formula, and it does not seem that they had a sufficient degree of consensus, in view of the opposition raised from the General Council of the Spanish Bar Associations -, while those that are included, are incorporated differently from the proposal from the governing body of our magistrates, judges and justices.

As far as we are concerned, leaving aside the procedural measures aimed at resuming judicial activity in the best possible way (to minimize both the risk of collapse due to the presumed increase in litigation and the risk of expansion of contagion in court offices and venues), Royal Decree-law 16/2020 introduces a series of interim or transitory measures in insolvency matters of great importance. We will now refer to those of substantive interest.

II. Possibility of proposing and approving a *second* composition with creditors

Firstly, with the purpose stated in the Explanatory Notes to the Royal Decree-law of maintaining the economic continuity of companies and self-employed workers who, prior to the entry into force of the state of alarm, had been regularly fulfilling the obligations arising from composition with creditors or mediated settlement agreement, the device of *amendment of the composition*, enabled for the first time by the Insolvency-Related Urgent Measures Act 9/2015 of 25 May and originating in Royal Decree-law 11/2014 of 5 September, is reintroduced to avoid the liquidation of those companies that after the crisis of 2008 achieved a composition that had become impossible to comply with.

As on that occasion, the measure is approved on a temporary basis without the intention of being permanent, in order to avoid the liquidation of those debtors who, during the period of one year from the declaration of the state of alarm, cannot comply with the payments committed to in the composition approved with their creditors or with the obligations contracted after the approval of said composition.

For these debtors, the duty to petition the opening of their liquidation is suspended, in order to allow them to negotiate and approve an amendment to the composition with their creditors *(cf.* Art. 9 of the Royal Decree-law). The request for amendment, which under Art. 8(1) of the Royal Decree-law may be submitted during the year following the declaration of the state of alarm, must be accompanied by *(i) a* list of all the claims subject to the composition and those subsequently incurred that are pending payment, *(ii)* a viability plan supporting the request for amendment, and *(iii)* the corresponding payment schedule. It should be noted that there is at least an apparent contradiction between the first paragraph of Art. 8, which allows the insolvent debtor to submit the proposed amendment to the composition until the end of the one-year period from the declaration of the state of alarm, and the first paragraph of Art. 9, according to which the insolvent debtor that knows that it is impossible to comply with its composition need not apply for liquidation provided that within the indicated period of one year it submits the proposed amendment to the composition and it is identified as suitable for consideration "within the said period" (the latter mention seems to oblige the debtors to submit their proposed amendment with sufficient time, so that, it can be identified as suitable for consideration by the Court before the expiry of the period of one year from the declaration of the state of alarm).

Unlike the rules contained in Act 9/2015, no reinforced quorums are now set out for the approval of the second composition, referring, without exceptions, to the regulation of the original compositions (it can be deduced that for all purposes of content, quorums and procedure - including the report from the insolvency practitioners that would have to be authorised for such purposes, and control by the same of the list of claims submitted by the debtor), and expressly stating that in no case shall the amendment affect the claims accrued or incurred during the period of performance of the original composition or the secured ('privileged') creditors on whom the composition was crammed down on or who accepted it once approved, unless they vote in favour of or expressly accept the proposed amendment.

Any applications for a declaration of non-performance of composition made by creditors during the six months following the declaration of the state of alarm shall be notified to the debtor, and shall not be processed until three months have elapsed since their submission, in order to allow the debtor to submit a proposed amendment to the agreement - which shall be processed on a preferential basis - within the same three-month period. It should be noted here that the purpose of the notification of the debtor of applications for a declaration of non-performance of composition submitted by creditors during - only - the first six months after the declaration of the state of alarm is unclear as the royal decree-law suspends the debtor's duty to apply for liquidation for a period of more than one year. And if the declaration of non-performance of composition were applied for after six and a half months, would the debtor no longer be notified? Would the debtor not then have the priority option of proposing an amendment to the composition? The legislative drafting seems clearly deficient on this point and it will certainly give rise to problems notwithstanding that there are not that many compositions with creditors in effect.

Finally, as under Art. 84(2)(11)(ii) of the Insolvency Act in relation to obligations assumed within the framework of an ordinary composition, and in order to favour the granting of credit facilities to debtors who are unable to comply with their original composition, credits derived from financing commitments or the provision of guarantees by third parties, including parties specially related to the insolvent debtor appearing in the proposed amendment approved by the judge, are classified as claims against the insolvent estate.

The above rules apply, *mutatis mutandis,* to mediated settlement agreements.

These are all necessary measures, which have been called for from various quarters, and this is without prejudice to their limited scope, given that, unfortunately, there are not many compositions with creditors in effect; more than 90% of petitions for insolvency proceedings end up in liquidation.

III. Temporary lifting of the ban on applying for court approval ('homologation') of a second refinancing arrangement within less than one year.

Secondly, and in line with the measures approved for the amendment of compositions with creditors or mediated settlement agreements, the possibility is provided for the submission and processing of proposed amendments to court-approved refinancing arrangements (i.e., schemes of arrangement), even if the one-year period from the first application for court approval has not yet expired. The ban contained in paragraph 12 of the fourth additional provision of the Insolvency Act (which prevents the debtor from applying for a second scheme of arrangement

within less than one year) is thus deactivated, albeit temporarily and for the same period of one year from the declaration of the state of alarm.

Art. 10 of the Royal Decree-law that we have been discussing, also provides for notification of the debtor of any applications for a declaration of noncompliance with the original refinancing arrangement that may be made by creditors within the six months following the declaration of the state of alarm - again, it is surprising that this notification provision is limited to the first six months, when the announced protection would stretch for one year from the declaration of the state of alarm -. Such applications for a declaration of noncompliance will not be suitable for consideration until one month after filing; this will enable the debtor to notify the court within the same period that it *has commenced or intends to commence* negotiations with its creditors to amend the existing refinancing arrangement or *to* reach a new one. The completion of the amendment of the refinancing arrangement or of a new one, must be notified to the court within the following three months, or else the creditors' applications for a declaration of noncompliance will be followed up.

Once again, the measure is logical and necessary, although the factual requirements must be properly monitored to prevent those debtors who fail to comply with schemes of arrangement for structural or other reasons - but which are not linked to the Covid-19 crisis - and who have no possibility of reaching an arrangement with their creditors, from making improper use of this protection mechanism, unnecessarily delaying their insolvency proceedings and - eventually - worsening their financial position.

IV. Exception to the subordination in insolvency proceedings of loans and credit facilities granted by parties specially related to the debtor

The exception introduced in Royal Decree-law 16/2020 to the subordination of credit facilities and loans granted to the debtor by specially related parties, within any subsequent insolvency proceedings of the debtor, is also reasonable and in line with similar measures adopted in other countries (e.g., Germany).

Thus, in order to facilitate credit and liquidity for companies, it was decided that those claims derived from fresh money, originating from parties specially related to the debtor, should be classified as senior unsecured ('ordinary') claims in the insolvency proceedings that could be opened within two years of the declaration of the state of alarm.

The wording of the relevant provision *(cf.* Art. 10(1) of the Royal Decree-law) seems to suggest that such claims can only benefit from the subordination exception and are therefore necessarily classified as ordinary. They cannot, therefore, aspire to a better treatment, if they were granted within the framework of a refinancing arrangement under the fourth additional provision or under Art. 71 bis of the Insolvency Act – in accordance with Art. 84(2)(11) -, or by the creation of security over assets of the same debtor to guarantee their return -would it be necessary in such a case to resort to a motion for insolvency recovery (antecedent and from directors et al.) or would such security be directly void as contrary to a prohibitive rule? –. However, those specially related parties who grant new credit facilities to the debtor are not totally safe from subordination within insolvency proceedings - should the insolvency practitioners seek avoidance (i.e., unwinding) of the financing contract in question and consideration of bad faith on the side of the related

creditor, with the effects that, in terms of classification of claims, would ensue based on Art. 73(3) of the Insolvency Act - ; for which reason it would have been desirable to complete the rule with an additional protection against insolvency proceedings.

Likewise, in insolvency proceedings opened within the years following the declaration of the state of alarm, those where parties specially related to the debtor have been subrogated as a result of the payment of ordinary or privileged claims made on behalf of the debtor after the declaration of the state of alarm, will receive the same classification of ordinary claims.

In view this last provision it is not difficult to imagine triangular relationships of new financing from/through related parties, which allow, on the side of the related party, to completely deactivate the risk of subordination from actions to avoid pre-insolvency transactions and, on the side of the debtor's ordinary creditors, to improve the ranking of their credits.

V. Suspension of a debtor's obligation to petition for insolvency proceedings until 31 December 2020

Finally, a debtor's general obligation in a current state of insolvency to petition for insolvency proceedings ('voluntary' insolvency proceedings) is exceptionally impaired so as to allow the debtor to gain time to restructure (i.e., adjust) its debt and/or obtain liquidity; either through the recovery of its ordinary business activity or through access to credit facilities from third parties or to public assistance.

Thus, until 31 December 2020, a debtor who is in a state of insolvency - which should be read as "current", as *imminent* does not require the filing of petition for insolvency proceedings - will not be obliged to apply for a judicial declaration, whether or not it has submitted a prior pre-insolvency notice under Art. 5 bis of the Insolvency Act. Accordingly, until that date, creditors' petitions for insolvency proceedings ('necessary' insolvency proceedings) from the declaration of the state of alarm will not be identified as suitable for consideration; thus, if before 31 December the debtor files a petition for insolvency proceedings, such will be processed preferentially.

It is not explained in the Royal Decree-law whether the debtor should have the possibility of extending the time limits even further by resorting to Art. 5 bis of the Insolvency Act; this could obviously mean both an abuse of an exceptional rule, and a risk of worsening of the debtor's financial position. Is it possible that a debtor that has been insolvent since, say, the end of March, can wait until 30 December before filing a notice under Art. 5 bis of the Insolvency Act, with the aim of further extending - by a further four months - the period already granted to negotiate with its creditors, or, on the contrary, can such a strategy be covered by the law when it is a clear abuse of rights?

The provisions of Royal Decree-law16/2020 concerning time limits, on this point, replace those contained in Art. 43 of Royal Decree-law 8/2020 of 17 March, thus repealed.