Investment funds

Pre-insolvency and Restructuring Plans in the Draft Insolvency Act Amendment Bill

Brief summary of the proposed changes to pre-insolvency proceedings under the Draft Insolvency Act Amendment Bill

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On 21 July, the Draft Insolvency Act Amendment Bill, transposing Directive 2019/1023 of 20 June 2019 (Directive on restructuring and insolvency) into Spanish law, was made public.

Following an analysis of the content of the draft bill – and without prejudice to the fact that the published draft may be further developed and ultimately undergo substantial modifications – we can conclude that this is a profound change in insolvency legislation, which, paradoxically, takes place just before the anniversary of the entry into force of the recast version approved last year.

The amendments introduced by the draft bill particularly affect pre-insolvency proceedings and propose profound changes with the main purpose of encouraging agreements between debtors and creditors in order to obtain a rapid resolution to debtors' insolvency problems. In practice, the changes introduced in the draft bill entail a total alteration of the former Articles 5 bis and 71 bis and the Fourth Additional Provision of the Insolvency Act, whose tenets are now included in Articles 581 *et seq*, 596 *et seq* and 605 *et seq* of the Insolvency (Recast) Act.

Some of the key features introduced by the amendments, on the basis of the draft bill, are as follows:

1. The amendment supresses mediated settlement agreements and refinancing arrangements and introduces so-called **Restructuring Plans** in their place. The change, as we shall see below, is not limited to the name.

2. In addition to the already-existing 'imminent insolvency' and 'current insolvency', the draft bill provides for a new state of affairs, prior to these scenarios, which is the **probability of insolvency**. This situation will occur when it is objectively foreseeable that, if a Restructuring Plan is not agreed, the debtor will not be able to regularly meet its obligations as they fall due, and considerably broadens (and legally recognises) the spectrum of situations that allow recourse to the financial restructuring instruments contained in insolvency legislation.

3. The main characteristics and effects of Restructuring Plans are as follows:

    - They may seek to modify the debtor's assets and liabilities or its equity, including transfers of assets, production units or the entire company.

    - Any claim, including (as expressly clarified) contingent and conditional claims, may be affected by the Restructuring Plan (only child support claims, claims in tort, employment-related claims not including senior management and public administration claims are excluded). In other words, the main new feature of the proposed new regime is the possibility of commercial liabilities also being affected.

    - In order for a Restructuring Plan to be approved, the holders of affected claims must vote separately according to the nature of their claims. Until now, refinancing arrangements were only aimed, or at least mainly aimed, at the refinancing of financial liabilities and, within this aim, only distinguished between two classes of creditors: those with secured and unsecured claims.

      In order to facilitate the formation of the classes, the draft bill sets out several criteria that seek to be as objective as possible, such as, for example, the existence of a common interest among the creditors making up the same class or the formation of the classes according to the classification of the insolvency claims and their priority within the framework of the possible insolvency proceedings.

      Nevertheless, the draft bill provides a mechanism for resolving any discrepancies that may arise in relation to the design of the creditor classes, as it allows these discrepancies to be submitted to the judge that is competent for the approval of the Plan before the latter has been filed for approval.

    - The Plan shall be deemed approved for each class of claims if creditors holding more than two-thirds of the liabilities in such class vote in favour. This majority goes up to three quarters in the case of secured claims. In the case of syndicate claims, the same majorities shall apply unless the syndication agreement itself stipulates a lower percentage. If the necessary majorities are not obtained, the votes shall be computed individually.

    - Another important new feature introduced by the draft bill — in line with the recommendations contained in

Directive 2019/1023 of 20 June 2019 — is the position of the shareholders when the Restructuring Plan affects their rights. In other words, when the approval of the Restructuring Plan involves measures such as capital increases, conversions or the disposal of essential assets which, under the general rules of company law, require their consent.

- In view of the different options set out in the Directive, the draft bill opts to recognise, as a general rule, shareholders' voting rights (and, therefore, the need for their approval) when the Restructuring Plan affects their rights. To this end, the draft bill respects the fact that the will of the debtor must be formed according to the rules applicable to the type of company in question, and therefore the rules laid down for other creditors are not applicable to the shareholders. However, certain special features are introduced in order to speed up the process and make it easier to reach an agreement favourable to the Plan.

- As regards the court approval of the Restructuring Plan, the draft bill introduces the following new features:

  — In accordance with the provisions of the Directive, a distinction is made between two different scenarios, described by legal scholars as "consensual plans" and "non-consensual plans".

  — In the case of a "non-consensual plan" and as also provided in the Directive, the draft bill establishes the possibility of carrying out what in common law terminology is known as a "cramdown" or "cross-class cramdown", that is, the imposition of the plan on dissenting creditors within a class that has voted in favour, on entire classes of dissenting creditors or even on the shareholders themselves if the shareholders in general meeting have voted against the Plan.

  — This will require at least one of the following:

    — The Plan must be approved by a simple majority of the classes, provided that at least one of them is a class of claims which in the insolvency proceedings would have been classified as special (secured) or general (preferential unsecured) priority claims.

    — The Plan must be approved by at least one class that can reasonably be presumed would have received some payment following a valuation of the debtor as a going concern.

- The draft bill also modifies the system for challenging judicial approvals and introduces two ways to file such challenges:

  — Objection prior to the approval Order. In the event of an application for approval of the Plan, the affected parties may lodge an objection with the Companies Court that is competent for approving the Plan. The court's judgment may not be appealed.

- Subsequent challenge of the approval Order. Once issued, the Order may be challenged before the appellate court (*Audiencia Provincial*) by the parties that did not approve it, whether they are creditors, debtors or shareholders.

• In terms of the financing granted to the debtor within the framework of the Restructuring Plan, the draft bill provides the following:

- On the one hand, it introduces the concepts of interim financing (bridge financing) or new financing.

- On the other hand, it grants both types of financing the following benefits in the event of a subsequent insolvency:

  - No clawback actions may be brought when the Restructuring Plan affects at least 51% of the total liabilities (unless it is proven that it was fraudulent as to the creditors). Nor may the acts, transactions or business deals carried out in the context of the Plan be clawed back if the same requirements are met.

  - Fifty per cent of both types of financing will be considered claims against the insolvent estate if the Restructuring Plan affects at least 51% of the total liabilities.

• The draft bill creates the position of Restructuring Expert, whose main defining characteristics are the following:

- A Restructuring Expert is appointed when requested by the debtor or by a significant percentage of the creditors affected by the restructuring, when the judge deems it appropriate or prior to filing a Restructuring Plan that will affect a class of creditors or the shareholders who did not vote in favour of the Plan.

- The functions of the Restructuring Expert will be to assist the debtor and the creditors in negotiating and drawing up the Restructuring Plan as well as to prepare the reports required by law or that the judge may deem necessary or convenient.

• On the other hand, the draft bill provides for the first time that, if a Restructuring Plan is being negotiated, a petition for insolvency proceedings filed by the debtor may be suspended by the judge, either at the request of the Restructuring Expert if one has been appointed, or of the creditors that, at the time of the petition, represent more than fifty percent of the liabilities that could be affected by the Restructuring Plan. The petition must evidence the filing of a Restructuring Plan that is likely to be approved.

• Likewise, the draft bill introduces important new features in Restructuring Plans in terms of the performance of contracts entered into by the debtor; such new features are aimed at facilitating the final objective, which is none other than for the debtor to be able to overcome its financial difficulties, and include the following:

— Contracts, including senior management contracts (with certain additional particularities), may be terminated in the interest of the restructuring. Any discrepancies that may arise in this respect will be resolved in the course of the challenge to the Plan and the judge may decide to reduce the agreed compensation.

— It expressly regulates that any contracts that are necessary for the continuity of the debtor's business or professional activity may not be suspended, modified, or terminated prior to their expiration date simply because the Restructuring Plan entails a change of control of the debtor.

4. Finally, it should be noted that the draft bill also amends the notification of the opening of negotiations with the creditors (the traditional “5 bis” or “pre-insolvency”). These amendments include the following:

   - The information and documentation to be provided together with the notification have increased significantly, making the procedure more serious and rigorous. Such documentation includes a list of the creditors with whom negotiations have begun or are intended to begin, which will allow greater control by the court over the true existence of the negotiations.

   - The effects of the notification may be extended for successive periods of 3 months (up to a maximum of 12 months), provided that the creditors representing 50% of the liabilities to be affected by the Restructuring Plan are in agreement (this percentage will rise to 60% as from the first extension).

   - During the 3 months following the notification of the opening of negotiations, any contracts that are necessary for the continuity of the debtor’s business or professional activity may not be suspended or terminated prior to their expiration date.

   - The notification will suspend the enforcement of guarantees or security provided by any other company in the group when such suspension is expressly requested and it is evidenced that the enforcement of the guarantee or security may cause the insolvency of the guarantor and the debtor itself.

   - In companies limited by shares, while the effects of the notification are in force, the legal duty to wind up the company in the event of losses that reduce the net assets to less than half of the share capital shall be suspended.

   - Any creditor may lodge an appeal for reconsideration of the decision if it considers that the assets or rights against which enforcement is being pursued are not necessary for the continuity of the debtor's business or professional activity or that the effects of the notification should not extend to certain guarantees granted by third parties.

5. Finally, we should point out that the draft bill exempts some of the rules mentioned above from being applied in cases where the debtor is a company with fewer than 49 employees, with an annual turnover of less than 10 million euros and does not form part of a group required to consolidate.

The so-called Special Scheme will apply to these companies, meaning that:

- The processing of the petition for the opening of insolvency proceedings filed by the debtor may not be suspended at the request of the creditors or the Restructuring Expert.

- The effects of the notification of the opening of negotiations at the debtor's request may only be extended once.

- Even if it has not been approved by all classes of creditors, the Restructuring Plan may be approved if the class or classes of creditors who have not approved it are treated more favourably than any lower-ranking class.