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Analysis of the new features of the Insolvency Act Amendment Bill

Restructuring Team

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Introduction

On 14 January 2022, the Insolvency Act Amendment Bill, approved by the Cabinet in its meeting of 21 December 2021 (hereinafter the "Bill" and the amendment it proposes, hereinafter the "amendment"), was published in the Houses of Parliament Journal.

This is the next step in the passage of the Draft Bill (hereinafter "Draft Bill") that we learned about last August and which will now continue through Parliament until it sees the light of day, in the form of an Act of Parliament, during the first half of this year.

The main purpose of this amendment is the transposition into Spanish law of Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (hereinafter, the "Directive")1 . In addition to harmonising Member States' insolvency laws, the Directive seeks to facilitate the early restructuring of economically viable but financially distressed companies.

However, apart from complying with the obligation to transpose the Directive, or rather, taking advantage of this legislative opportunity, the Government intends to undertake a far-reaching remodelling of the Spanish insolvency system provided in the Recast Version of the Insolvency Act (TRLC).

The reasons behind this objective, which is more ambitious than the transposition of the Directive would require, are mentioned in the Bill's own explanatory notes (which follow the argumentation already contained in the Draft Bill). The aim is to provide a solution to the limitations and inefficiencies of the current system, which often prevent viable companies that are in financial difficulties from finding solutions, finding themselves instead forced into insolvency proceedings and, in many cases, liquidation.

The statistics mentioned in the Bill's explanatory notes are sufficiently illustrative: *a*) 45% of debtors who file for insolvency proceedings do so already in a critical situation; *b*) the average duration of insolvency proceedings in Spain is 60 months; and *c*) 90% of Spanish companies that file for insolvency proceedings end up being liquidated. With these statistics, it is not surprising that the level of confidence of debtors and creditors in the insolvency process, as currently defined, is discouraging[2] .

[1] The deadline for this, after a first extension, is 17 July 2022.

[2] The statistics published each year by the Registry of Forensic Economists of the General Council of Economists (REFOR-CGE) are quite revealing of the phenomenon that some have referred to as "flight from insolvency". Taking as a reference the period 2017-2019, the study prepared by REFOR-CGE concludes that Spain was at the bottom of the European countries in terms of the number of insolvency proceedings opened. The average annual number of insolvency proceedings in Spain was four thousand four hundred companies per annum, which is clearly lower than the French situation (with fifty-two thousand insolvency proceedings per year), the German situation (with twenty thousand insolvency proceedings per year) or the Italian situation (with twelve thousand insolvency proceedings per year). Even countries such as Portugal, with a gross domestic product six times lower than Spain's and with four times less population than our country, surpassed us in the average annual number of insolvency proceedings (more than five thousand). The case of Denmark is also striking, with almost double the number of insolvency proceedings (more than 8,000), although it is a much smaller country with a much lower gross domestic product.

Accordingly, the leitmotiv of the changes announced in the Draft Bill and maintained in the Bill is the resolution - once and for all - of the many limitations of Spanish insolvency law which had not been resolved in the numerous amendments introduced since the passage of Act 22/2003.

Naturally, the analysis of the amendment cannot ignore the particular context and moment in which it is taking place; the serious economic crisis caused by the COVID19 pandemic has made it necessary for the Government to approve a battery of measures (such as temporary collective redundancy procedures – ERTE –, SEPI – Spanish state-owned industrial holding company – recapitalisation funds, ICO – State-owned credit institution – loans and insolvency moratoriums) to try to provide support (and, in some cases, *assisted breathing*) to our companies.

In fact, the end of the last extension of the insolvency moratoriums approved by the Government[3] will coincide in time with the estimated date of entry into force of what we hope will be useful tools a) to provide an early solution to business situations of financial difficulty that can really avoid insolvency and b) to provide a framework that preserves the business value of those companies that will necessarily be forced into a state of insolvency.

Against this background, we offer below a detailed analysis of the most substantial changes of the Bill, highlighting their differences both with the current system and, where relevant, with what was announced in the Draft Bill approved in August.

Main changes included in the Bill

In order to facilitate understanding of the most substantial changes[4] proposed by the amendment, we will first deal with those affecting pre-insolvency law. Once these have been detailed, we will analyse the changes introduced in the conduct of the insolvency proceedings themselves.

[3] Royal Decree-law 27/2021, of 23 November, extending certain economic measures to support the recovery, approved the extension of the moratorium granted on the duty to file for insolvency proceedings until 30 June 2022.

[4] There are many changes in the articles of the current regulation. In this article we will focus on those we consider most important.

Amendment of Spanish pre-insolvency law

This is undoubtedly the most important new feature of the amendment.

At present, a debtor in an actual or imminent state of insolvency can conclude a refinancing arrangement with creditors (collectively or individually), obtain the necessary support for an early composition with creditors proposal or submit to the mechanism of a mediated settlement agreement[5].

If the debtor needs the negotiations for the foregoing to be carried out without being subject to enforcements or creditor petitions for insolvency proceedings that compromise the outcome of the negotiations, it can also give the notification under Article 583 TRLC (currently known colloquially as "5 *bis*" and hereinafter referred to as "pre-insolvency"). This - with few exceptions[6] - will give the debtor a protective shield of three months. If the arrangement, composition or agreement is not reached within these three months, the debtor will be obliged to petition insolvency proceedings in the following business month, provided that the state of insolvency persists.

Any arrangement, composition or agreement reached with creditors during this stage must guarantee continuity of the business as a going concern and be approved by the creditors holding claims representing a significant majority (three-fifths) of the company's liabilities.

If, in addition, it intends to cram down the effects of said agreement on dissenting creditors, the Recast Version of the Insolvency Act in force only allows the debtor to do so on so-called *financial* creditors and provided that it is submitted for judicial approval or 'homologation' (for which creditors holding claims representing 51% of the financial liabilities must have approved it) and has the favourable vote of creditors holding claims representing a very significant percentage of the secured liabilities (65% - 80%, depending on the type of measures to be imposed) or, as the case may be, of the unsecured liabilities (60% - 75%).

The companies court will only intervene in the pre-insolvency period in the case of homologation to analyse whether the formal requirements are met and, in the event of a challenge, whether the cramdown of effects entails a disproportionate sacrifice for dissenting creditors.

Moreover, at present, except for mediated settlement agreements - and, more recently, the pre-pack mechanism introduced by the Barcelona courts - there is no provision for the participation of any mediator, external to the parties, who could coordinate the process and help the debtor and the creditors to reach an arrangement or composition.

This whole scheme will undergo a radical change with the entry into force of the amendment.

If the text of the Bill is kept, we will no longer have two "insolvency scenarios", imminent or current, as a third one will be added to the existing ones, that of *likelihood of insolvency*, which will be at an even earlier stage than imminent insolvency. On this point, the Bill goes one step further than the Draft Bill and specifies that we will be in the scenario of likelihood of insolvency when it is objectively foreseeable that the debtor will not be

[5] Book II of the TRLC, Art. 583 et seq.

[6] Assets not necessary for the continuation of the business, enforcement of public administration claims and secured claims (in the latter case, only for the purpose of initiating enforcement proceedings).

able to meet the obligations that fall due in the following two years[7].

The introduction of this new first scenario of likely insolvency seems to us to be appropriate in order to make it possible - now without conceptual doubts and with express legal recognition - to use the new restructuring mechanisms in the most incipient stages of financial difficulty, in order to turn them into truly effective *early restructuring* tools, in line with the postulates of the Directive.

Thus, as soon as the company is likely to become insolvent, the pre-insolvency notification may be given, which undergoes significant changes with respect to the current model, mainly aimed at facilitating successful negotiations, becoming a much more regulated procedure. Likewise, the approval of what both the Directive and the amendment call restructuring plans may be requested, with also substantial differences with respect to the current rules governing refinancing arrangements, including the possibility of attaching commercial debt and assets and contracts, and even with the possibility of dragging along shareholders and the debtor itself.

As the most important changes focus on the treatment of pre-insolvency and the so-called *restructuring plans*, the two institutions will be analysed separately below to facilitate the understanding of the new rules.

Changes in the notification of pre-insolvency

As we have said, the changes envisaged in the amendment are far-reaching, given that it moves from a sparse and imprecise regulation to a much more regulated and protective pre-insolvency scheme.

First, the duration of the protective period is extended, with the possibility of requesting an extension of three months in addition to the three months initially granted[8]. The extension will also be required to be requested before the expiry of the first three months and to be requested or approved by creditors holding claims representing 50% of the liabilities likely to be affected by the possible restructuring plan[9].

In other words, there would be a total of 6 months, plus the additional month granted to prepare and file for insolvency proceedings, if it has not been possible to conclude a restructuring plan to avoid or overcome the state of insolvency.

On this point, the Bill presents a substantial alteration with respect to the rules anticipated in the Draft Bill, as it cuts by half the pre-insolvency period contained in the Draft Bill, which allowed a series of extensions up to a maximum duration of twelve months. The alteration is probably a good idea since, in general, a period of seven months

[7] Art. 584(2) TRLC, Bill.

[8] Art. 607 TRLC, Bill.

[9] It should be noted that Article 608 of the Recast Version of the Insolvency Act Amendment Bill gives creditors the power to lift the cramdown effects, as the judge will agree to such lifting if creditors holding claims representing 40 % of the liabilities affected so request (60 % in the Draft Bill). In addition, a creditor is allowed to request that the cramdown effects be dispensed with if the cramdown would cause him unjustified harm (in particular, his insolvency) or would significantly diminish the value of his collateral.

(six plus one) seems sufficient to undertake most of the negotiations of the restructuring plans, while a longer period generates a situation of excessive uncertainty and possible lack of protection for the creditors affected by the effects of the pre-insolvency notification.

The amendment also entails a transformation of the content of the notification[10], which is no longer a succinct document that merely informs of the start of negotiations with creditors, but a more detailed document, in which the debtor is required to provide information[11] that was not necessary until now.

Apart from serving to control the legitimate use of the pre-insolvency tool[12], the extra information required from the debtor is aimed at allowing the effects of the pre-insolvency to be applied, which the amendment introduces as a novelty with respect to the current Recast Version of the Insolvency Act.

Thus, it will be necessary to provide a list of the contracts necessary for the continuity of the activity in order to prevent (subject to certain exceptions) the suspension of their performance or their termination due to breaches prior to the notification of pre-insolvency[13].

Likewise, the judge seized of the notification may, at the request of the debtor, extend the stay or restraint of enforcements against assets and rights that are not necessary for the continuation of the activity when it is necessary for the successful conclusion of the negotiations.

Similarly, if the aim is to prevent the enforcement of security provided by companies belonging to the same group as the debtor (which is not provided for in current legislation), this must be expressly stated in the notification, detailing the reasons or motives why such enforcement would jeopardise the viability of both the debtor and the guarantor[14].

Finally, in line with the objective of encouraging the adoption of restructuring plans that avoid the opening of insolvency proceedings, the amendment introduces two important new features in the regulation of pre-insolvency:

- The Bill provides (following the provisions of the Draft Bill itself) that, while the effects of pre-insolvency are in force, the legal duty to pass a resolution for a wind-up due to losses that reduce equity to an amount lower than half of the share capital will be suspended[15], thus resolving once and for all the doubt as

[10] Article 587 of the Recast Version of the Insolvency Act Amendment Bill allows joint notification by several debtors (in particular, companies of the same group).

[11] The information to be provided with the pre-insolvency notification is detailed in Article 586 of the Recast Version of the Insolvency Act Amendment Bill. This introduces, as a relevant change with respect to the Draft Bill, the need to provide a certificate of being up to date with tax and Social Security obligations if the agreement may affect claims against the Public Administrations.

[12] Experience to date has shown that pre-insolvency was often used as a delaying tool, aimed not so much at reporting or promoting a context of serious negotiation, but rather at gaining time to prepare for the insolvency procedure without the debtor's assets being jeopardised by the commencement or continuation of enforcements.

[13] Art. 598(2) TRLC, Bill.

[14] Art. 596 TRLC, Bill.

[15] Art. 613 TRLC, Bill. Sixth final provision TRLC, Bill, amending Article 367 of the Recast Version of the Companies Act.

to whether giving the pre-insolvency notification is sufficient grounds for the impairment of the directors' liability in statutory winding up events.

- And, on the other hand, in an unprecedented development in Spanish insolvency law, it allows the restructuring expert or creditors, holding claims representing more than 50% of the liabilities to be affected by a restructuring plan likely to be approved, to apply to the judge for a stay of the debtor's petition for insolvency proceedings[16].

Consequently, we are faced with a pre-insolvency device of greater scope, both in terms of its duration and its effects[17], which should result in achieving the ultimate aim pursued by the amendment, which, it should be remembered, is to allow for the negotiation and signing of agreements between debtor and creditors that, in the pre-insolvency stage and as early as possible, avoid or make it possible to overcome a state of insolvency. The new pre-insolvency rules thus make evident the legislator's redoubling of its commitment, in line with the postulates of the Directive, to pre-insolvency mechanisms and tools.

In our opinion, the changes are positive both in terms of facilitating tools for the achievement of restructuring arrangements between creditors and debtors and also in terms of preventing or hindering unreasonable or abusive manoeuvres by debtors and their shareholders.

Restructuring plans

While the changes that the amendment introduces in pre-insolvency are very significant, even more important and far-reaching are the changes introduced in respect of the content, majority rules and drag-along capacity of the agreements that may be reached to overcome or avoid the state of insolvency. These changes begin with the name itself, since refinancing arrangements or mediated settlement agreements disappear and are now called *restructuring plans*.

However, beyond the name, the fundamental changes introduced in the new restructuring plans would be the following:

- As regards the content of the restructuring plans:

  a. In contrast to the current rules[18], it is expressly provided that new *restructuring plans* may cover not only liabilities but also assets and equity capital, including

[16] Art. 612 TRLC, Bill. However, this stay will be lifted one month after the debtor's filing for insolvency proceedings if the creditors have not made an application for judicial approval of a restructuring plan. This is in any case an important measure, as in practice it was not uncommon to find debtors (or their shareholders) putting pressure on their creditors by filing for insolvency proceedings in order to achieve an agreement more favourable to their interests. And such pressure was often effective if the insolvency proceedings could - and often did - lead to a devaluation of assets that worsened the prospects of recovery for the creditors.

[17] Pre-insolvency essentially maintains the prohibition on the commencement or continuation of enforcement by creditors currently provided for in the Recast Version of the Insolvency Act. What is new in the Bill, with respect to the Draft Bill, is that it is not necessary for creditors holdings claims representing 50% of the total financial liabilities to support the suspension of enforcements derived from these liabilities.

[18] The amendment certainly does not include any provision that lists, numerus clausus, the possible content to be imposed on dissenting creditors, as the current legislation does, which has led to disparate court decisions on the possibilities of cramming down effects on dissenting creditors.

the sale of assets or production units[19] or even the whole company[20], as well as the termination of contracts with outstanding reciprocal obligations and senior management contracts[21].

b. On the liabilities side, unlike the current rules, where the effects of a refinancing arrangement can only be crammed down on dissenting creditors holding financial claims[22], the restructuring plan will also allow the drag-along of creditors holding claims representing other liabilities (even of a contingent or conditional type), even if they are of a different nature, in particular commercial[23], public administration[24] and even shareholder creditors[25].

- As regards the approval of the restructuring plan:

a. In contrast to the current rules, for the approval of the restructuring plan, claims will have to be grouped into classes beforehand. The amendment gives great leeway to the parties promoting the restructuring plan for the configuration of each class, simply providing general guidelines or principles to ensure the objectivity of the differentiation of each class (*i.e.*, the existence of a common interest, equality of rank or typology of the claim)[26].

It must therefore be concluded that the new restructuring plans are based on

[19] Art. 614 TRLC, Bill.

[20] The amendment does not sufficiently specify what would be the outcome of a restructuring plan based on the sale of the whole company; however, it may well be interpreted that such an option is admissible provided that the continuation of the business activity is supported by the relevant viability plan and that the company transferring the business unit can be subject, once the restructuring plan has been approved, to ordinary liquidation.

[21] Art. 620 TRLC, Bill.

[22] Art. 606.2 TRLC. Financial claims are considered to be those arising from any financial indebtedness on the part of the debtor, regardless of whether or not the holders of these claims are subject to financial supervision.

[23] Art. 616 TRLC, Bill. Only maintenance, kinship or marriage claims, tort claims and employment claims other than those of senior management may not be affected by the restructuring plan.

[24] Art. 616 *bis* TRLC, Bill. The possibility of affecting public administration claims is a novelty of the Bill (which was not contained in the Draft Bill). However, the attachment of public administration claims is limited, as it requires the debtor to be up to date with tax and Social Security obligations at the time of applying for pre-insolvency and homologation; the restructuring plan may only affect debts that are no more than two years old and only payment deferrals of up to eighteen months from the pre-insolvency application or up to twelve months from the homologation decision (reduced to six months if a deferment or instalment has already been granted) may be applied.

[25] Art. 640 TRLC, Bill.

[26] Art. 623 TRLC, Bill. Certain classes of necessary configurations are provided for. Thus, secured claims must constitute a single class, unless the heterogeneity of the encumbered property or property rights justifies their separation into more than one class (Art. 624 TRLC, Bill). This provision also establishes that claims of the same insolvency rank may be separated into different classes when there are reasons that justify it. These reasons include the financial or non-financial nature of the claims, the existence of conflicts of interest that creditors forming part of different classes may have or even how the claims are going to be affected by the restructuring plan. In what constitutes a novelty with respect to the Draft Bill, Article 624 *bis* of the Recast Version of the Insolvency Act Amendment Bill clarifies that public administration claims will also constitute a single class.

a much more flexible configuration of classes of claims than the current judicially approvable ('homologable') refinancing arrangements, which only provide for the formation of two classes of claims (always financial), depending on whether or not they are secured.

b. As a general rule, the restructuring plan will be deemed to be approved when it has the favourable vote of each and every one of the classes affected by the plan. To this end, the favourable vote must be obtained, in each class, either by creditors holding claims representing more than two thirds of the liabilities included in it if we are talking about a class without security[27], or by at least three quarters in the case of a class made up of secured claims.

c. When the restructuring plan affects claims linked by a syndication agreement, the contractual agreements on procedure and exercise of voting rights shall be respected and the majorities established in section *b* above shall apply, unless the syndication agreement itself provides for a lower majority to approve these effects. In both cases, and if the necessary majority votes in favour, it shall be understood that the creditors holding all the syndicated claims accept the restructuring plan. If the required majority is not obtained, the votes shall be counted individually, unless the syndicated creditors form a single class, in which case the restructuring plan shall be deemed not to have been approved by that class[28].

- As regards the homologation of the restructuring plan:

  a. The amendment provides that the homologation of the restructuring plan will be required[29] when it is intended to cram down its effects on dissenting creditors or classes of creditors or on shareholders; also when it is intended to terminate contracts or protect interim financing and new financing provided for in the restructuring plan - as well as the acts, operations or transactions carried out in the context of said plan - against avoidance actions[30] that could be brought in subsequent insolvency proceedings. In this way, in such cases, due judicial control is ensured and an adversarial channel is made possible to ensure sufficient protection of all the interests at stake.

  b. As regards the cramming down of effects on dissenting creditors or classes of

[27] Art. 629 TRLC, Bill.

[28] Art. 630 TRLC, Bill. Unless they have been affected by virtue of the contractual clauses of the syndication agreement itself, creditors who have not voted in favour of the plan may oppose or challenge it in accordance with the provisions of this Title.

[29] Art. 635 TRLC, Bill.

[30] Arts. 615 and 667 TRLC, Bill. In order to protect new and interim financing against clawbacks in subsequent insolvency proceedings, approval of the restructuring plan is required. Such protection will be total for restructuring plans whose claims affect 51% of the total liabilities, unless it is proven that they were carried out defrauding creditors. If such majority is not reached, they shall be avoidable if they are detrimental to the assets available for distribution, without the presumptions established by law to determine the existence of such detriment being applicable. Interim financing or new financing granted by specially related persons shall only be protected if the claims affected by the restructuring plan represent more than two thirds of the total liabilities.

creditors, it should be noted that the amendment provides for not only *intra-class* dragging (the dragging along of dissenting creditors within a class that has voted in favour), but also the dragging along of entire classes of dissenting creditors, the so-called inter-class dragging. In this sense, in the absence of the relevant majority within each of the classes, inter-class dragging is allowed provided that the restructuring plan has been approved by a simple majority of classes (if one of them corresponds to secured claims) or, failing that, by at least one class that can be presumed to have received any payment following a valuation of the debtor as a going concern[31].

c. Therefore, the legislator, aware of the disputes that may arise between the affected parties regarding the class configuration itself (given the importance of this for the homologation of the restructuring plan and the expectations of *intra- and inter-class* dragging - think of possible artificial constructions aimed at facilitating approval within a class or the imposition of the entire plan on the other classes), the amendment includes a prior incidental procedure for pre-approval by the homologating judge of the class configuration (Art. 625 TRLC, Bill), which both the debtor and the creditors holding claims representing more than 50% of the liabilities to be affected by the restructuring plan may make use of.

d. Another important change is the possibility introduced to impose the restructuring plan on the debtor, the shareholders or both. Thus, unlike the current rules, in which it is not possible to impose a refinancing arrangement on the debtor (and, indirectly, on the shareholders), the amendment provides for the possibility of dragging along the debtor[32] and the dissenting shareholders, provided that the majority of the creditors' votes in favour indicated in the Bill are obtained and, furthermore, the company is in a state of current or imminent insolvency. In other words, it is not possible to drag the shareholders along or impose the plan on the debtor itself in a situation of mere likelihood of insolvency, which, on the other hand, seems logical and reasonable, given that the value of the company - and therefore of its shares - at such an initial stage of insolvency may not have deteriorated substantially[33].

e. In this regard, a new feature is also included[34] with respect to the current system, which states that when the restructuring plan contains measures that require the agreement of the debtor's shareholders, the general rules applicable to the debtor's type of company will apply, with the specificities regarding deadlines, calls for meetings and rules for adopting and challenging resolutions provided for in Article 631(2) of the Recast Version of the Insolvency Act, in

[31] In accordance with the classification of claims provided for in Article 639 of the Recast Version of the Insolvency Act Amendment Bill. In this case, the application for homologation must be accompanied by a report from the restructuring expert on the debtor's value as a going concern.

[32] Only if it is a legal person (Art. 640(1) TRLC, Bill).

[33] It is true, however, that the parliamentary passage of the amendment and the procedure amendments thereto should be used to better define the concept of 'likelihood of insolvency' as opposed to 'imminent insolvency', i.e. to better define where one case ends and the other begins.

[34] Art. 631 TRLC, Bill.

the version established in the Bill, rules that generally provide greater flexibility and speed in shareholder approval. Likewise, the amendment grants the directors - or someone designated by the homologating judge at the proposal of any creditor with legal standing - the power to carry out the acts necessary for execution when the plan contains measures that require the passage of a resolution at the shareholders' meeting but such has not been passed[35].

- As regards the appointment of the restructuring expert:

  — In order to ensure a proper balancing of interests and to protect the interests of all parties affected by new restructuring plans, the amendment provides for the necessary appointment of a restructuring expert when homologation is sought for a restructuring plan whose effects will cram down onto one or more classes of creditors or on shareholders who did not vote in favour of the plan when their vote is required under company law[36].

  — In other cases, the appointment shall not be mandatory and shall only be made at the request of the debtor or creditors holding claims representing 50% of the liabilities affected by the plan, or by the judge in the event of a general stay of enforcements or an extension of such a stay.

- Finally, as regards the rules for challenging a homologation, the amendment substantially modifies them and introduces the possibility of using the following two routes:

  a. On the one hand, it provides for the possibility, at the request of the applicant, for the parties concerned to lodge an opposition before the homologation decision is issued. In this case, the judgment will not be appealable[37].

  b. As an alternative, the amendment allows for the challenge of the homologation decision, but for its resolution not by the homologating judge, but by the Provincial Court[38].

Finally, as we anticipated, the new features of the amendment are substantial and far-reaching. In fact, they affect all the cardinal axes of the current system: the very content of the restructuring plan (the intention being apparently to make it more flexible), the claims that may be affected and dragged along, the position of the company's shareholders, the actors involved in the process and the system of majorities.

In fact, the changes included in the amendment in this area show the legislator's commitment (in line with the postulates of the Directive) to pre-insolvency mechanisms and tools.

As we highlighted at the beginning, in our view, the introduction of the likelihood-of-insolvency scenario will allow the use of the new restructuring mechanisms in the most incipient stages of

[35] Art. 650.2 TRLC, Bill.

[36] Art. 672 TRLC, Bill.

[37] Arts. 662 et seq. TRLC, Bill

[38] Art. 653 et seq. TRLC, Bill. It should be pointed out that Art. 657 TRLC, Bill, also allows the termination of contracts with reciprocal obligations pending performance that have been agreed in the homologation decision to be challenged.

difficulty, turning them into veritable early restructuring tools.

The rest of the changes proposed in the amendment in the pre-insolvency stage provide tools that, while promoting the achievement of agreements between creditors and debtors, facilitate mechanisms that seek to prevent or hinder unreasonable or abusive strategic manoeuvres by debtors and their shareholders that could end up jeopardising the viability of the company.

That said, and without prejudice to the foregoing, the relevance -and novelty- of some of the proposed changes makes it advisable to take advantage of the parliamentary passage of the Bill to provide a greater degree of specificity and explicitness to some of the aforementioned changes.

Thus, for example, with regard to the imposition of the restructuring plan on dissenting classes of creditors, it would be appropriate to better develop the dragging mechanism proposed in Article 639 of the Recast Version of the Insolvency Act, clarifying points such as the percentage of the claim that would have been paid by the class that approves the plan or whether the simple majority of the classes refers only to the number of classes or also to the combined claim amount.

The same could be said in relation to the distinction between the scenarios of likely insolvency and imminent insolvency, which with the current wording seem to overlap, making it difficult to see when one ends and the other begins. This aspect may be key in the event of seeking to impose the restructuring plan on the debtor's shareholders, as we have seen.

Or, finally, it could be made explicit that - as it seems - the legislator is opting for a much more flexible system for restructuring plans in terms of the possible content of the agreements, as well as with regard to possible measures that can be imposed on dissenting creditors and classes.

Amendments to insolvency proceedings

The second large group of relevant measures of the amendment are aimed at improving the conduct and functioning of the insolvency proceedings themselves.

Directive 2019/1023 mandates Member States to adopt the necessary measures to ensure that insolvency proceedings are conducted quickly and efficiently. And, as we said at the beginning, the historical analysis of our most recent insolvency experience reveals that the aforementioned dual objective of speed and efficiency is far from being achieved.

For this reason, throughout the amendment a series of procedural modifications have been established that seek to streamline the process, aiming to make it less rigid and more efficient, and which seek to adapt its conduct to the characteristics of small and medium-sized companies.

We will now analyse these amendments by grouping them according to the following subjects: procedural amendments, creation of special schemes, amendments in the process of release from unsatisfied liabilities and amendments in the qualification section.

Procedural amendments

The measures aimed at speeding up the process are as follows:

- The maximum duration of the insolvency proceedings is limited to twelve months from

the opening of the first section (opening of insolvency proceedings) to the closing of the fifth section (composition/liquidation), without prejudice to the judge being able to agree to extend this period in view of the possible complexity of the insolvency proceedings or circumstances that may arise[39].

- The need to opt for liquidation or composition is brought forward to the presentation of the insolvency practitioner's interim report. It will no longer be necessary to wait for the final texts to be drawn up[40] as it is considered that such a wait was one of the main causes of the delay in the conduct of insolvency proceedings[41].

- The early composition and the need to hold a creditors' meeting are abolished, establishing the system of written acceptances of the early composition proposal that currently exists[42].

- The need for the judge to approve a liquidation plan is eliminated. Instead, the amendment opts to establish "general liquidation rules"[43], empowering, however, the insolvency judge, when ordering the opening of the liquidation stage or in a subsequent decision, to establish "special liquidation rules"[44] depending on the composition of the assets, the foreseeable difficulties in the liquidation or any other concurrent circumstances. The insolvency practitioner will liquidate the insolvent estate in accordance with the legal rules or, where appropriate, in accordance with those special rules established by the insolvency judge.

- The amendment also contains new rules relating to the petition for insolvency proceedings along with the submission of an offer to purchase one or more production units, seeking to speed up their disposal[45]. These new rules allow the debtor to submit a binding written proposal for the acquisition of one or more production units together with the petition for insolvency proceedings, with the clear aim of maintaining the value of the company to the greatest extent possible.

- The amendment adapts the Bill to the experience (albeit short) accumulated with the pre-pack mechanism, establishing the possibility of appointing an expert to obtain bids for the acquisition of production units in the pre-insolvency stage[46]. On this point, the Bill has established as a novelty the obligation of

[39] In view of the current overload of Spanish companies courts, it is difficult to believe that these time limits can be observed.

[40] Arts. 296 *bis* and 337 TRLC, Bill.

[41] Bringing this procedural milestone forward may have negative consequences. In insolvency proceedings in which disputes of the list of creditors or of the inventory of property and property rights are important, it can be very difficult to put together a credible composition proposal if the liabilities (or their classification) are in doubt. It may even affect the liquidation as well, as it may make it impossible to be uncertain about the assets to be realised (or their value) or the debt to be paid once the proceeds of their realisation have been obtained.

[42] Art. 351 TRLC, Bill.

[43] Arts. 421 et seq. TRLC, Bill.

[44] Art. 415 TRLC, Bill.

[45] Art. 224 *bis* TRLC, Bill.

[46] Art. 224 ter TRLC, Bill.

the acquirer to continue or restart the activity with the production unit(s) acquired for a minimum of three years, providing that failure to do so may entitle any aggrieved party to claim compensation from the acquirer for the losses caused[47].

- The amendment introduces rules that seek to avoid judicial pronouncements (with the consequent delay that this entails) in traditionally conflictive matters. Thus, in the event that the assets available for distribution are insufficient to meet the claims against the insolvent estate, the claims that will be considered essential for the preservation and liquidation of the assets available for distribution are specified, thereby eliminating the often cumbersome process of prior judicial confirmation that was currently required. Thus, such essential claims include claims for workers' salaries accrued after the opening of the liquidation stage as long as they continue to provide their services, the remuneration of the insolvency practitioner during the liquidation stage and the amounts owed from the opening of the liquidation stage in terms of rent for the properties rented for the preservation of property and property rights of the assets available for distribution[48].

Creation of the special scheme and the micro-enterprise scheme

In its attempt to make the insolvency process more efficient, the amendment creates two schemes that seek to adapt the rules of the insolvency process to small and micro-enterprises.

Some of these specialisations are required by the Directive and others are explained by the need to reduce costs and facilitate access to pre-insolvency mechanisms.

Firstly, the amendment creates what it calls the *special scheme*, which will apply to natural or legal persons carrying on a business or professional activity, provided that their average number of employees during the financial year prior to the insolvency proceedings does not exceed forty-nine persons and their annual turnover does not exceed ten million euros[49].

The most important features of this special scheme are the following[50]:

- The possibility of imposing a restructuring plan without the debtor's approval is excluded.

- 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 that have not supported it are treated more favourably than any lower ranking class.

- Debtors will be provided with official templates for restructuring plans and will be exempted from notarial attestation for the

[47] Art. 224 *septies* TRLC, Bill.

[48] Art. 250(2) TRLC, Bill.

[49] Arts. 682 et seq. TRLC, Bill.

[50] Art. 684 TRLC, Bill.

formalisation of the plan and from the auditor's certification[51].

- The processing of the debtor's petition for the opening of insolvency proceedings may not be suspended at the request of creditors or the restructuring expert.

- The effects of notifying the opening of negotiations at the debtor's request may be extended only once. The debtor alone shall be entitled to request the extension of the effects of notifying the opening of negotiations.

- The homologation of the restructuring plan may only be requested if the debtor and, where applicable, the shareholders have approved it. Likewise, judicial confirmation of the classes of creditors may only be requested by the debtor.

Secondly, the amendment also proposes the inclusion of a specific scheme for micro-enterprises[52] (or micro-SMEs), which it defines as companies with fewer than ten employees and annual revenues of less than two million euros[53].

The special procedure designed for them seeks to reduce the costs of the procedure by eliminating all formalities that are not strictly necessary and reducing the participation of professionals and institutions to those cases in which they fulfil an essential function or whose cost is assumed voluntarily by the parties.

The procedure provides for two possible routes to be indicated at the time of the application for the opening of the procedure[54]: a fast-track liquidation[55] or a flexible and quickly managed continuation procedure[56].

The special liquidation procedure is designed to provide microenterprises with a simple, quick and flexible instrument. Unless creditors request the appointment of an insolvency practitioner, the debtor itself will liquidate the assets. In order to proceed with the liquidation, debtors will have access to a liquidation platform which will be free of charge and universally accessible.

For its part, the continuation procedure provided for microenterprises is an adaptation of the rules provided for restructuring plans, although, unlike the latter, it will be conducted once the insolvency proceedings of the microenterprise have been initiated[57].

The procedure provided for microenterprises also proposes an abbreviated characterisation section of the insolvency proceedings[58] in which the aim is to reduce the time limits established in

[51] Art. 684.1 TRLC, Bill.

[52] However, the Bill introduces as a novelty in its second transitional provision that the scheme applicable to micro-enterprises will not enter into force until 1 January 2023.

[53] Arts. 685 et seq. TRLC, Bill.

[54] Art. 697 TRLC, Bill.

[55] Arts. 705 et seq. TRLC, Bill.

[56] Arts. 697 et seq. TRLC, Bill.

[57] Arts. 698 and 698 *bis* TRLC, Draft.

[58] Art. 717 TRLC, Bill.

the ordinary procedure. The section maintains the important role given to creditors in the ordinary scheme (to which we will refer later). Creditors holding claims representing more than 10% of the liabilities may submit their own characterisation report, although only the insolvency practitioners or public administration creditors may themselves support the characterisation of the insolvency proceedings as being at fault[59].

Release from unsatisfied liabilities

- The amendment also introduces important changes to the procedure for the release from unsatisfied liabilities, as follows[60]:

- The objective requirement under the current Art. 488 of the Recast Version of the Insolvency Act for access to release is eliminated, which will no longer be conditional on the satisfaction of a certain type of debt (as is the case under the current law[61]) and the attempt to reach mediated settlement agreement.

- Instead, a release system on merit is adopted in which any debtor, whether an employer or not, provided that he meets the standard of good faith on which this instrument is based, can be released from all his debts, unless the exceptions or prohibitions set out in Articles 487 and 488 of the Bill apply.

- Among the exceptions that will mean the non-existence of good faith is included as a novelty, with respect to the letter of the current Recast Version of the Insolvency Act, that in the ten years prior to the application for release, the debtor has been declared an affected person in the judgement of characterisation of the insolvency proceedings of a third party characterised as at fault, unless on the date of application for release he had fully paid his liability.

- The release is extended to all insolvency debts and claims against the insolvent estate, except for those which, exceptionally and due to their special nature, are considered legally non-releasable.

- Non-releasable debts are maintenance debts, debts with the public administration - the release from which is subject to limits -[62], debts arising from a criminal offence or from liability in tort, as well as those corresponding to the legal costs or expenses arising from the processing of the release itself and secured debts.

- Lastly, exceptionally, the judge is allowed to declare the total or partial non-releasability

[59] Art. 717 TRLC, Bill.

[60] Arts. 486 et seq. TRLC, Bill.

[61] We should remember that Article 488 of the Recast Version of the Insolvency Act establishes that, currently, in order to be eligible for release, it will be necessary to have fully met the claims against the insolvent estate and the secured claims.

[62] Arts. 488 and 489 TRLC, Bill. This point is a change of the Bill with respect to the Draft Bill. On the one hand, the possibility is introduced of extending the release from the claim held by the Public Treasury and the Social Security, but, on the other hand, this release is limited to the amount of one thousand euros for each of these public bodies. Likewise, this power will only be present in the first application for release and not in subsequent applications for release.

of certain debts where necessary to avoid the creditor's insolvency.

Amendment in the characterisation section

Finally, the forthcoming amendment of the insolvency procedure also entails significant changes to the characterisation section of the insolvency proceedings.

The most immediate affects the formation of the section itself. Thus, the amendment brings forward the procedural moment at which this will take place, placing it in the decree that puts an end to the common stage. In other words, it will no longer be necessary to wait for the approval of the liquidation plan or the passing of the judgement approving the composition (of *burdensome* content) to confirm whether or not the section is opened.

And it will not be necessary to wait because the legislator simply seems to want the characterisation section to be conducted in any case. Hence the proposal to eliminate the exception provided for in the current Art. 446 of the Recast Version of the Insolvency Act, which would allow the opening of the section to be avoided if a so-called *non-burdensome* composition is approved[63].

This amendment is transcendental because it puts an end to the already widespread practice of taking advantage of the current exception to try to avoid the characterisation determination. As recognised in the amendment's own explanatory notes, it was sufficient to include in the composition "a clause for full and immediate payment of insolvency claims of less than one hundred euros, or a 5% haircut for small claims".

Secondly, the amendment gives a more prominent role to creditors. Creditors holding claims representing at least 10% of the liabilities or holding claims in excess of €1 million, as well as public administration creditors[64], will also be able to file a characterisation report and pursue, on their own, the opening of insolvency proceedings[65].

This modification means a profound change from the current system, in which the creditors had a much more residual role that obliged them to always *follow*[66] what the insolvency practitioner and the Public Prosecutor's Office determined[67]. If these two bodies agreed in classifying the insolvency proceedings as no fault, the determination was final without referral, and this, even if there were creditors interested in instigating at-fault insolvency proceedings.

Thirdly, the amendment also contains important procedural changes that should be highlighted:

[63] Non-burdensome compositions are those included in the current Article 446(2) of the Recast Version of the Insolvency Act, compositions in which, for all credits or for those of one or several classes or subclasses of those established in the said Act, a forgiveness of less than one third of the amount of those claims or a deferral of less than three years is established.

[64] The introduction, for the purposes of legal standing, of creditors with claims of more than one million euros and public administration creditors is a new feature of the Bill compared to the provisions of the Draft Bill.

[65] Art. 449 TRLC, Bill.

[66] This was established by the Supreme Court in its Judgment of 3 February 2015, in which it established the doctrine of simple joining intervention.

[67] As a consequence of the appearance of the creditors' report, the participation of the public prosecutor's office is reduced to cases in which the creditors' report reveals the existence of a criminal offence.

— Thus, special rules on costs are included. The judgement rejecting the insolvency practitioner's request for the insolvency proceedings to be characterised as at-fault will not order payment of the costs incurred, except in the case of recklessness. In the same way, the judgement declaring the insolvency at-fault will not order the persons affected by the characterisation or those held accomplices to pay the costs. Nothing is said with regard to creditors who themselves support the at-fault characterisation of the insolvency proceedings, so it must be understood that they will assume the risk of a hypothetical finding of liability in this respect.

— In the same way, the amendment expressly regulates the effects of a possible settlement concerning the characterisation of the insolvency proceedings. According to the current terms, this may only affect the economic terms of the finding of liability and, prior to its approval, the parties involved in the determination of this issue must be notified so that they can make the representations they see fit[68].

Finally, to conclude the analysis of the changes introduced in the characterisation section, reference should be made to two novelties contained in the Bill in contrast to the version of the Draft Bill published in August.

On the one hand, the express reference to the possibility of including the debtor's auditor as an accomplice during the three years prior to the insolvency proceedings has been eliminated. The reasons for the elimination of this express reference are unknown, as are the reasons that led to its incorporation, since in both cases the explanatory notes are silent on the matter.

On the other hand, it is worth highlighting the introduction of a new rebuttable presumption of at-fault insolvency proceedings in the event of non-compliance with the composition, which consists of the debtor's failure to claim the obligations due.

In short, the amendment clearly aims to strengthen the characterisation section, which will always and in any case be conducted, and in which the creditors - who under the current rules are often marginalised from the conversations and agreements reached between the reporting insolvency practitioner and the debtor who is seeking a quick end to the section- will have a leading role.

The attention paid to the characterisation section is in any case surprising for two main reasons:

— Firstly, because it does not seem that the conduct of the characterisation section was one of the main problems of the current insolvency framework. In fact, it is not mentioned in the description of the endemic ills of insolvency law in Spain in the explanatory notes. Rather, on the contrary, the possible conduct of the characterisation section and its outcome has historically been one of the concerns of debtors in difficulties and their directors when deciding to file for often inevitable insolvency proceedings.

— Secondly, because the explanatory notes themselves recognise that strengthening the characterisation section is not one of the objectives of the Directive, which has no provisions on the characterisation of insolvency proceedings. Moreover, as is also acknowledged in the explanatory notes themselves, this is a device that is not reflected in the rest of the legal systems around us, where, on the

[68] Art. 451 *bis* TRLC, Bill. The service to the parties in person is a change of the Bill.

contrary, criminal insolvency law is highly developed.

This being so, the amendment is perhaps disruptive at this point with respect to the strengthening of pre-insolvency tools, especially because it may interfere in the negotiations held in the pre-insolvency stage, as creditors perceive it as a powerful bargaining tool.

3. Conclusion

Taking advantage of the transposition of Directive 2019/1023 into Spanish law, the executive has drawn up a Bill amending the Spanish insolvency system that entails profound changes with the aim of providing a definitive response to some of the endemic problems that our insolvency and pre-insolvency praxis has been revealing.

In reality, the amendment proposes a complete transformation of pre-insolvency law with several aims: *a*) to anticipate actions as early as possible in order to protect the value of the company; *b*) to provide the necessary tools to facilitate the achievement of pre-insolvency solutions, and *c*) to give more room for manoeuvre to creditors, who may in some cases impose restructuring on the debtor's shareholders. And in the same line of arranging truly effective pre-insolvency mechanisms for the protection of business value, we have the inclusion in the amendment of the historical demand for the possibility of attaching liabilities of a non-financial nature (although a more decisive step towards a greater degree of submission of public administration claims to the plans would be desirable) and the capacity to operate on contractual relations also as possible content of the plan.

In short, the amendment seeks in effect to encourage - driven by the reasons behind the Directive - recourse to pre-insolvency mechanisms between a debtor and creditors at the earliest possible moment and with much greater flexibility than hitherto, with the ultimate aim of avoiding unnecessary insolvency proceedings with traumatic effects for the parties concerned.

This is undoubtedly a positive move and we believe that, with due clarification of the still obscure or poorly defined angles - some of which are highlighted here - it should help to overcome the situation into which a large number of companies in this country may regrettably be plunged in the near future.

Finally, and also noteworthy, the amendment provides for numerous measures aimed at making the Spanish insolvency procedure more agile and efficient by modifying procedural steps that delayed the conduct of the process and adapting its rules to small and medium-sized companies.

In any case, from now on it will be necessary to closely monitor the parliamentary passage of the Bill in order to verify whether, in the end, the rule that comes into force keeps the aforementioned changes in their entirety and in the same terms.

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