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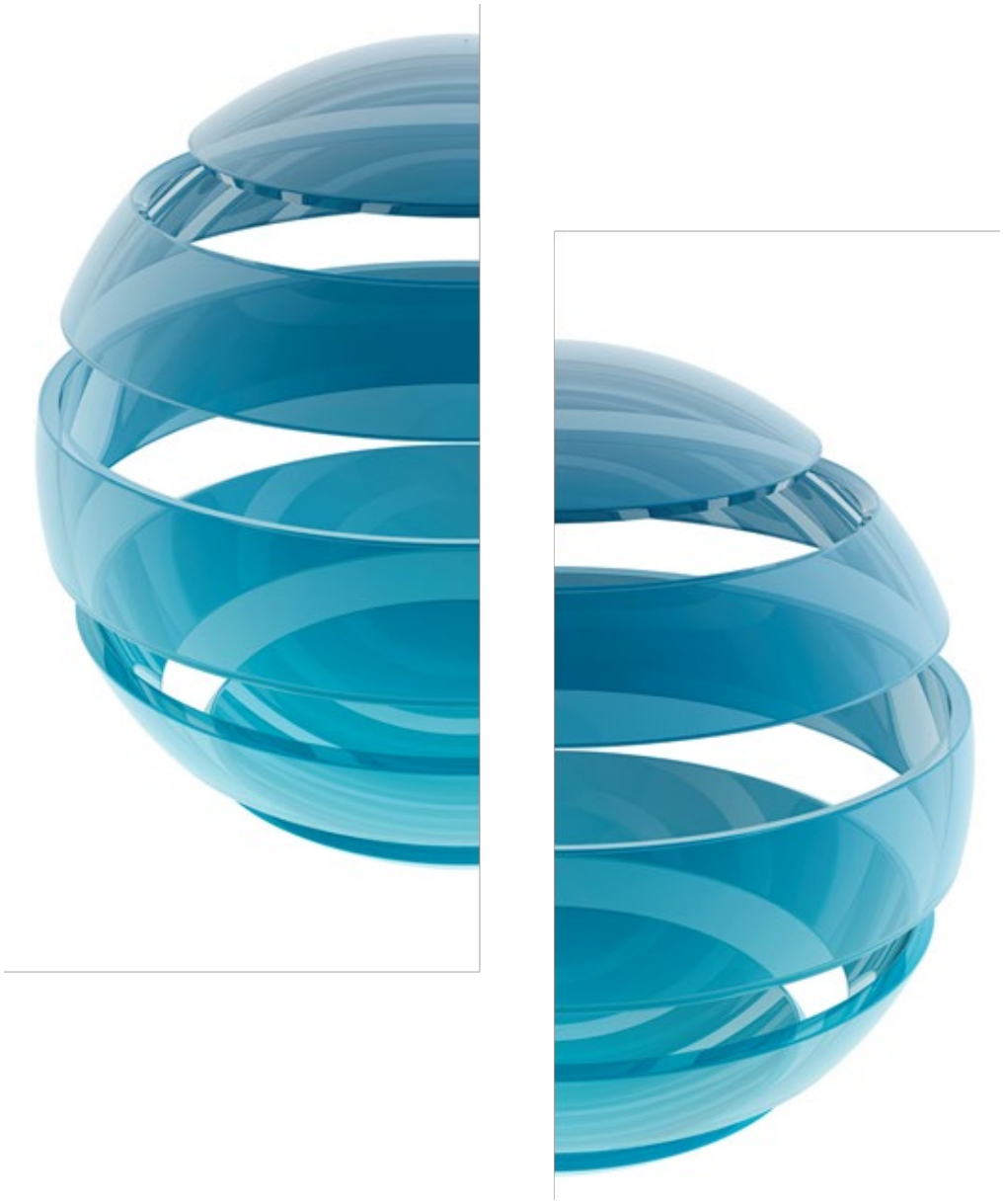


The Recast Insolvency Law: beyond a mere consolidation |

Publication of Royal Legislative Decree 1/2020, of 5 May, approving the Consolidated Text of the Spanish Insolvency Law

May 2020

On 6 May, 2020, the new Consolidated Text of the Spanish Insolvency Law (*Texto Refundido de la Ley Concursal* – the **Consolidated Insolvency Law - CIL**) finally came to light, through the publication of Royal Legislative Decree 1/2020, of 5 May in the Spanish Official Gazette. More than five years have passed since the Spanish Government received the mandate[1] to prepare a consolidated text of Spanish Law 22/2003 of 9 July on Insolvency (*Ley Concursal* – the **Insolvency Law**) and almost a year since the Ministry of Justice submitted the draft bill prepared by its Codifying Commission to public consultation.

As stated in the Preamble to the CIL, "*the history of the Insolvency Law is the history of its reforms*", with more than 25 amendments since its enactment in 2003, especially after the onset of the financial crisis, from 2009 to 2015. In some jurisdictions, it even came to be referred to as the *Frankenstein Act*. The different amendments resulted in a poorly systemised Insolvency Law, leading to strong debates about its interpretation and application on numerous occasions. The successive reforms generated an unstable and hard-to-follow legal framework for a law that is crucial to developing and protecting business activities.

The new CIL emerges as a text that aims to clarify and harmonise insolvency regulations. In this sense, the **different sections have been grouped into subjects** for easier identification and interpretation. Thus, for example, a new Part II has been included in which all subjects relating to the so-called **Pre-insolvency law** are grouped, including the notification of the opening of creditor negotiations (formerly provided for in section 5 bis of the Insolvency Law), the refinancing agreements referred to in former section 71 *bis* and the Additional Provision Four of the Insolvency Law, and out of court settlements.

The approval of the CIL is also a first step towards implementing European insolvency legislation, in particular Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on restructuring and insolvency, which must take place before 17 July 2021. Likewise, the CIL has already adapted its references to the new European Regulations on insolvency proceedings and to the Spanish Law on International Legal Cooperation in Civil Matters (*Ley de Cooperación Jurídica Internacional*) concerning the recognition of rulings handed down in foreign legal proceedings (sections 721 to 752 of the CIL).

However, as is usually the case in these consolidation processes, the initiatives of the CIL goes beyond the systematisation of sections and subjects but also **several provisions have been expanded and amended**, so as to clarify their contents and incorporate and adapt them to current insolvency case law. Therefore, a law that did not exceed 250 sections has now more than 750.

Finally, it should be clarified that the act does not modify insolvency rules recently approved with regard to Covid-19 crisis. The CIL must be understood as a necessary instrument for improving the restructuring of Spanish undertakings and sustaining the business fabric of Spain during any economic cycle. **It is not a crisis relief law, but rather a legal foundation to solve and remedy insolvency situations, regardless of their cause**.

[1] Through Final Provision Eight of Spanish Law 9/2015 of 25 May, on urgent measures in insolvency matters.

Declaration and processing of the insolvency (sections 1 to 56 of the CIL)

Amendments are made to the objective premise for **necessary insolvency** (section 2): the existence of a confirmed court or administrative insolvency declaration will be a revealing fact of insolvency.

Processing of necessary insolvency petitions

- It is established that the Judge must **declare involuntary insolvency immediately** (section 14.2) **in the event that there are seizures pending enforcement** that affect the assets as a whole (previously, this was only an event where the debtor was summoned to oppose the petition).
- The **summoning of the debtor** (section 16) is developed and must be carried out at their domicile or residence; in the case of legal entities, they may be summoned (alternatively) through their directors, liquidators or chief executive officers.
- The **content of the debtor's opposition** is developed allowing them to rely on: (a) the petitioning creditor's lack of standing; (b) the absence of a revealing fact of insolvency; or (c) the fact that, at the time of the events underlying the petition, the debtor was not insolvent or is no longer in that position (section 20).
- If the insolvency petition is rejected in the first instance, but upheld by the Provincial Court of Appeals, the date of the Commercial Court judgment rejecting the insolvency petition will be set as the insolvency declaration date (section 26), thus avoiding a recurrence of what happened in the Nozar Case, where up to three different insolvency declaration dates were cited.

Publicity and registration of the insolvency declaration

- The excerpts that are published must refer to the intervention regime or the suspension of the debtor's rights of management and disposal (section 35).
- The **registration of the declaration of insolvency in public Registries will only be performed once the petition becomes final** (sections 36 and 37).

Jurisdiction

- The insolvency proceedings of individuals not involved in business activities are assigned to the Courts of First Instance (section 44).
- Following the case law established by the First Chamber and the Conflict Chamber of the Supreme Court, section 52 sets out the exclusive jurisdiction of insolvency Courts to establish the necessary nature of an asset or right for the continuity of the business activity of the insolvent debtor.
- The regime of the parties potentially affected by the liability actions heard by the insolvency judge is also developed (section 52). Also noteworthy is the possibility of the Court to order the consolidation of estates in joint insolvency proceedings (section 43).

Finally, in terms of systemisation, **former section 5 *bis* of the Insolvency Law** (on the notification of the commencement of negotiations with creditors to restructure the debtor's liabilities) is moved to the new Part II that governs pre-insolvency situations.

Effects of the insolvency declaration on the debtor (sections 105 to 155 of the CIL)

For the first time, **payments to the insolvent party are regulated** (section 110): they will only be a valid discharge of the debt if the insolvency declaration was not known at the time of the payment or supply. Knowledge of the insolvency will be presumed from the moment of its publication in the Spanish Official Gazette. Thus, the authorisation of the insolvency administrators will no longer be required.

The **liability actions regime** will be extended (section 132). The range of parties affected by these actions is broader: it now expressly includes individuals permanently appointed to act as representatives of the legal entity director and individuals who have been attributed executive faculties in the company when the powers of the Board have not been permanently delegated to one or several chief executive officers.[2]

Effects on the actions and proceedings in which the debtor is a party

- In **proceedings joined to the main insolvency proceeding**, the appropriate appeals according to Law may be lodged as though those proceedings had not been joined (section 138.3). With regard to mediation agreements and arbitration clauses, their suspension may only be applied for before the corresponding proceedings begin (section 140.3). Finally, it is clarified that the rule on the jurisdiction over new proceedings ceases to apply when a creditors' agreement enters into force (although the rule will apply again in case of breach).
- With regard to **enforcement proceedings**:
  - for **labour enforcements and administrative proceedings**, their suspension may be lifted when testimony of the insolvency judge's decision is included stating that the corresponding assets are not necessary for the continuity of the activity (section 144);
  - for the **enforcement of in-rem security rights**, these may be suspended whether or not the security beneficiaries are also insolvency creditors (therefore regulating for the first time the status of the insolvent debtor as a third party pledgor) and provided that the disposal has not occurred or the auction announcements have not been published (section 145);
  - the declaration of **assets as necessary**, a gap that existed in the previous law has been expressly regulated and the regime for these applications has been developed, specifying that the legitimacy to file the application will correspond to the secured creditor and the filing of one application will not prevent the filing of subsequent applications when the circumstances concerned have changed (section 147); and
  - a **penalty of invalidation** is included **for enforcement actions against the insolvency estate that breach the general suspension rule**.

Effects on claims

- The case law of the First Chamber of the Supreme Court of April 2014 is incorporated: once the insolvency has been declared, **the offsetting of claims will only be applicable for claims derived from the same legal relationship** (except for the particularities of private international law and without prejudice to those cases where the requirements for offsetting the claims had arisen prior to the insolvency declaration) (section 153).
- It is clarified that the fact of having notified that claim will not prevent offsetting it.
- As regards the **accrual of interest on secured claims**, the latest decisions of the Supreme Court are incorporated with regard to the recognition and payment of interest in insolvency proceedings. Hence, it is clarified that, as an exception to the general rule of suspension of the accrual of interest, **only remunerative interests (as opposed to default interests) will accrue at the "agreed" rate for up to the "value of the collateral"** (section 152.2).

[2] This extension reflects the rule provided in the Spanish Corporate Enterprises Act (*Ley de Sociedades de Capital*) for the corporate liability of directors, which also includes individual representatives and general directors.

Effects of the insolvency declaration on contracts (sections 156 to 168 and 190 to 191 of the CIL)

Embodiment of the **general principle of validity of contracts** (section 156) that was already implied in the previous wording of the Insolvency Law.

For the **extinction of contracts in the interest of the insolvency proceedings**, the prior appearance before the insolvency judge to reach possible termination settlement before filing the claim is now merely discretional. It differs from the compulsory nature of that procedure under the previous wording of the Law (section 156).

It is expressly regulated that, for **private contracts signed with public administrations**, the regime of the CIL will only apply in the absence of specific legislation governing the effects of insolvency declarations in those contracts (section 191).

Composition of the insolvency estate (sections 192 to 225 and 239 to 241 of the CIL)

Section 200 defines the **productive unit** as a **set of means organised in order to carry out an essential or accessory business**.

Regarding these:

- an obligation is established to create an appendix to the inventory describing the debtor's establishments, operations and productive units and listing the assets and rights making up each of those units; and
- **the preferred realisation method will be judicial or extrajudicial auctions (including electronic auctions)** (section 215).

The jurisdiction of the insolvency judge to determine the possible existence of corporate succession is established. Likewise, it is clarified that, for corporate succession purposes, labour and social security claims will not be transferred for contracts not transferred to the buyer of the unit.

With regard to **applications for the direct realisation or transfer in lieu of payment of a special privileged claim**:

- **these may also be filed by secured creditors** (sections 210 and 211);
- they **will remain subject to the legal regime for transfer in lieu of payment or as payment** of those assets governed in the Law (section 211) and that will be **possible at any stage of the insolvency proceedings**, provided the secured creditors give their express prior consent;
- **the authorisation** for transfer in lieu of payment **must require that the subsequent realisation of the asset is carried out for an amount not less than its market value**. In these cases, **if there is any surplus, it must be included in the insolvency estate**; and
- in cases where the affected assets are included in establishments or productive units, the CIL extends the realisation rules previously applicable to the liquidation stage (former section 149.2 of the Insolvency Law) to any stage of the insolvency proceedings (section 214), therefore substantially improving the flexibility to transfer assets at any stage of the insolvency proceedings.

Claw-back actions (sections 226 to 238 of the CIL)

It is clarified that, although the insolvency administrators may not have filed a claw-back action within two months of the creditors' request, this will not prevent **the insolvency administrators from bringing that action in the future (regardless of whether the requesting creditors have filed the action or not)** (section 232.2).

The effects derived from **upholding claw-back actions against unilateral acts** are regulated, specifying that the corresponding judgment must order the restitution of the benefit to the insolvency estate and the inclusion of the corresponding claim (as an insolvency claim) in the creditors' list (sections 235.3 and 236.2).

Determination of the insolvency estate (sections 242 to 268 of the CIL)

- A new subsection 14 has been added to section 242 recognising **claims allocated to the insolvent party to finance the viability plan in a winding-up situation as claims against the insolvency estate**. However, this character of claims against the estate will not be recognised in cases where the holder of the claim was or had been a specially related person.

- **Limits have been placed on the instances in which judicial or administrative enforcement actions can be brought to make claims against the insolvency estate effective**: they may only be brought in cases of approval of a creditors' agreement and from the effective date of that agreement (section 248).

- A **definition of "litigious claims"** is included in line with the position defined by case law (section 262): a claim will be considered litigious from the moment the reply to the claim is submitted to the proceedings.

In relation to the delayed notification of claims, it is clarified that, to avoid the application of the general subordination principle, it will be necessary to prove that knowledge of the claims came after the expiry of the deadline for challenging the initial report (section 268).

Classification of claims (sections 269 to 314 of the CIL)

Recognition of special privileged claims (section 271): for the privilege to apply, **the security must have been created prior to the insolvency declaration**. Specifically:

- **In respect of pledges of credit rights**: it suffices that the pledge was granted in a document with effective date prior to the date of insolvency declaration; and
- **In respect of pledges over future credit rights derived from the termination of concession contracts**: the pledge must have been constituted, authorised by the contracting authority and published in the Spanish Official Gazette before the date of the insolvency declaration.

It is confirmed that the **specially privileged claim limitation to the fair value of the security asset** applies solely **for the purposes of the creditors' and refinancing agreements**, but **not with regard to the right of recovery** with the proceeds of the guarantee (section 272).

Claims of tax and social security authorities (section 280): it is specified that the calculation base for determining the privilege (50% of the corresponding claims) will not include specially privileged claims, ordinary claims from withholdings and subordinated claims of those bodies.

In relation to **subordinated claims, two refinements are introduced**:

- In the case of delayed notification of claims, subordination will not apply to claims of mandatory recognition (among others, those recorded in documents with executive force or secured with an in rem security in a public register) (section 281.1.1).
- The **subordination of profit participating loans,** questioned by certain court decisions, is expressly confirmed (section 281.1.2).

New features are also included in the **content and presentation of the insolvency administrators' report:** when communicating the draft report to creditors, it must be specified the date on which the draft will be submitted to the Court (section 289). It is also specified that the inventory must include a list of ongoing litigation and the claw-back actions to be exercised (section 293).

Proposal, content and approval of the insolvency composition with creditors (sections 315 to 405 of the CIL)

For the proposed insolvency composition with creditors' (*convenio*) to contemplate **the conversion of labour claims**, the individual consent of the holders of those claims must be obtained (section 327.2).	New section 330 provides for the possibility of including the **assignment of claw-back actions of the insolvency estate to creditors as one of the possible alternatives within the content of the** insolvency composition with **creditors**.
Processing of proposals: the admission of ordinary proposals will be subject to appeal for reconsideration and, subsequently, the question may be raised again on appeal (section 345.2) together with the insolvent party's right to oppose the approval of the insolvency composition with creditors (section 380.2).	**New event of breach of the** insolvency composition with **creditors**: the infringement of measures prohibiting or limiting the exercise by the debtor of asset-related powers during the compliance stage of the creditors' agreement (section 402.2). For specially privileged creditors bound by the insolvency composition with creditors, once the declaration of breach becomes final, they may initiate or resume separate enforcement of their security, notwithstanding the commencement of the winding-up phase (section 404).

Liquidation phase (sections 406 to 440 of the CIL)

The CIL expresses an idea that was implied in the previous regime: regardless of the content of the plan, **the disposal of assets subject to specially privileged claims (i.e. security assets) and the disposal of productive units or the company as a whole must respect the specialities contemplated** in the corresponding sections of the CIL (section 415). A new rule is also included for the assets that will streamline the processing of liquidation procedures by providing that approval of the liquidation plan will be equivalent to authorising the disposal of the assets when this is expressly stated in the liquidation plan (section 419.2).

A new section 420 has been added that regulates the **possibility of requesting the amendment of the approved liquidation plan** at any time should it be considered appropriate in the interests of the insolvency proceedings and the prompt satisfaction of creditors. Its processing will be adjusted to the schedule contemplated for the approval of the plan.

The CIL contemplates the obligation for the approval order to contain the full text of the approved liquidation plan, which will be very useful for legal practitioners by avoiding the inclusion of non-standard documents, which attempt to manually add the changes made by the courts to the plans proposed by insolvency administrators.

On **payment to creditors**, the CIL includes two noteworthy amendments:

- the possibility of **making preventive appropriations** not only for appeals against winding-up operations, but also to secure the outcome of appeals (current or potential) against challenges to the list of creditors (section 425); and
- for the **payment of the remaining part of specially privileged claims that have not been settled** against the assets, former section 157.2 of the Insolvency Law has been adapted to specify that the proportional settlement with the rest of the ordinary claims will only apply for the remaining part not classified as a subordinated claim (i.e. the part corresponding to the principal will be settled proportionally with the rest of the ordinary claims, but not any interest that is not covered by the enforcement of the guarantee).[3]

[3] The previous drafting of these provisions allowed the interpretation to be defended that whatever was not covered by the proceeds from the special privileged should all be classified as ordinary claim.

Classification of the insolvency proceedings (sections 269 to 464 of the CIL)

Change in the assumptions that allow the opening of the classification section upon approval of the insolvency composition with creditors. Under the previous drafting of the law, for the classification section not to be opened, it was sufficient for the insolvency composition with creditors to contemplate a write-down of less than one third or a moratorium of under three years. Under the new provisions, it will be necessary for the insolvency composition with creditors to meet both requirements in order for the classification section not to be opened.

With regard to the parties potentially affected by the classification of the insolvency proceedings, all the references to general proxies have been replaced by general directors (section 442).

With regard to the **penalty consisting in covering the creditors' deficit** in the event that the insolvency is classified as a guilty insolvency, new section 456.2 defines deficit as the difference between the value of the assets and rights in the inventory drawn up by the insolvency administrators compared to the amount of recognised claims, which will encourage insolvent parties to seek the highest possible valuation of the assets.

The **judge's power is expressly established to determine the joint and several liability** of those condemned for guilty insolvency.

Termination of the insolvency proceedings (sections 465 to 507 of the CIL)

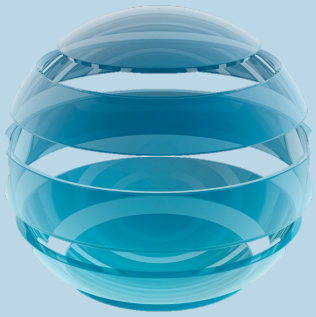
New **autonomous assumptions for the termination** of the insolvency proceedings:

- the finalisation of the settlement of assets and rights with application of the proceeds to the creditors' satisfaction (sections 465.4 and 468); and
- the existence of a single creditor in the definitive creditors' list (also in section 303.3).

Regarding so-called "*express insolvency proceedings*", the legislator has clarified and confirmed, with the new section 471, that anyone who can evidence a legitimate interest will have standing to challenge the resolution on appeal.

For applications for **insolvency proceedings to be continued**, the scope of the possible actions that the applicant will be entitled to exercise is defined (section 476.3), specifying that these actions must have been identified in the application.

On the **accountability reports** of the insolvency administrators, it is established that they must expressly detail the remuneration established for each phase and any amounts received both by the administrators and by clerks, experts and any other entities engaged, also stating the number of employees assigned by the insolvency administrators and the total number of hours spent (section 478).



Pre-insolvency instruments – refinancing agreements (sections 583 to 630 of the CIL)

Effects of notification of initiation of negotiations with creditors (the notification set out under former section 5 *bis* of the Insolvency Law):

- This is limited to the negotiation of collective refinancing agreements and early proposals for insolvency composition with creditors.
- It will not in itself cause the early termination of the claims (section 586), which is an important change (as provided for in many financing contracts). However, in the case of personal guarantors, it will not prevent the enforcement of their guarantees if the claims have expired (section 587).
- In relation to the assets necessary for the commencement of enforcement proceedings, it is clarified that the term of prohibition on the commencement of these proceedings will last three months from the submission of the notification (section 588).

On the **classes of refinancing agreements**, the legislator rearranges the agreements under former section 71 *bis* and Additional Provision Four of the Insolvency Law into two categories:

- collective refinancing agreements (which may or may not be homologated in court (*homologados judicialmente*) and, if the commencement of negotiations has been notified, must be signed within three months of their submission); and
- individual refinancing agreements signed with one or several creditors (section 596).

Homologation procedure (*homologación*) for collective agreements: this may be applied for by the debtor or by any creditor who has signed the refinancing agreement at any time. If the notification of commencement of negotiations with creditors has been made, the application must be submitted within three months of the submission of the notification (sections 605 and 610).

The **rule that restricts to one the number of homologations (*homologaciones*) that can be requested per year considers both homologation requests submitted by the debtor and those submitted by its creditors** (section 617). This rule has been included making clear reference to the Abengoa case.

As for the **calculation of majorities**, it will be considered that the members of a syndicate of creditors in which the majority of 75% have signed the agreement will be bound by it: this is not a drag-along effect, but rather it will be considered that 100% have adhered to the agreement (section 599.2).

On the **content of the agreement**, the possibility of **transferring the debtor's assets and rights to creditors** is contemplated, clarifying that, if the claims are capitalised, creditors will have a term of one month to decide between capitalisation or an equivalent write-down.

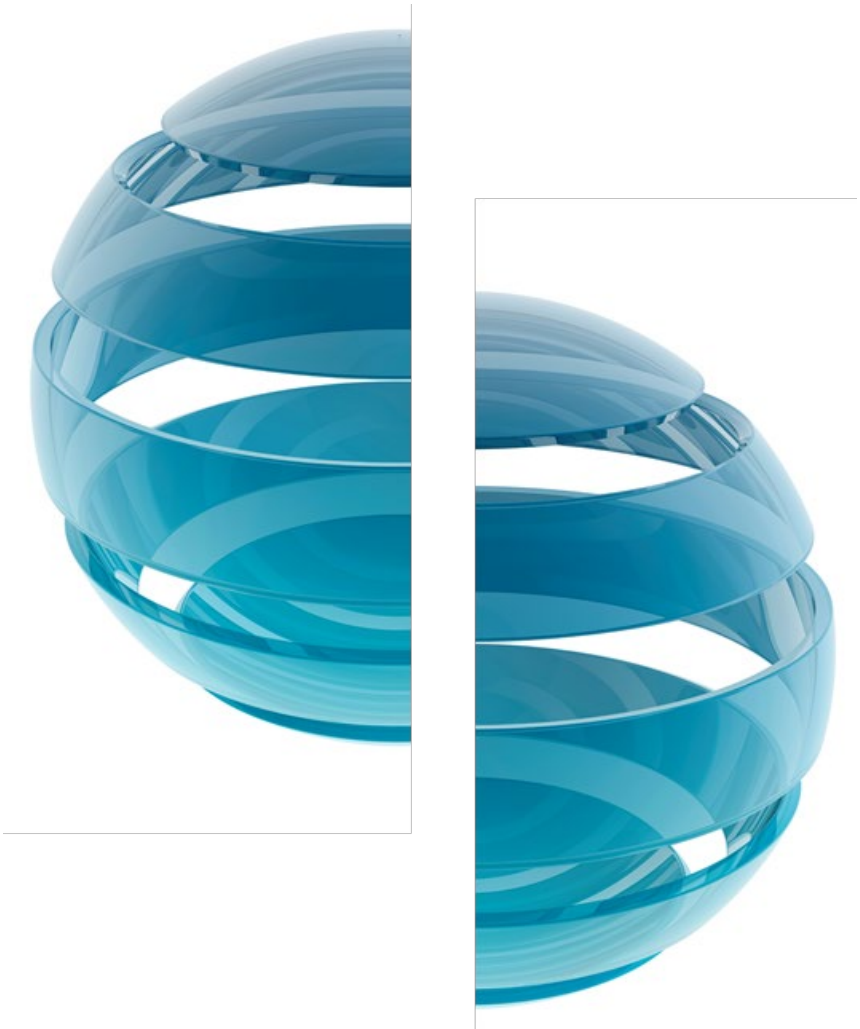
For **challenges to the homologation (*homologación*) of collective agreements**:

- Although the grounds for challenge remain unchanged, the **presumption of disproportionate sacrifice** is established for situations where the sacrifice required from equal or similar creditors is different or where the recovery offered to non-secured creditors under the refinancing agreement would be less than the recoveries that they could made in the liquidation of the estate of the debtor (section 619.3). This way the judicial interpretation set out in the ruling of the Commercial Court of Seville in the famous Abengoa case, has been incorporated into the law.

As to the **effects of a successful challenge against the homologation (*homologación*)**, again in line with the case law established in the FCC and Abengoa cases, it is clarified that this will not constitute a loss of effects towards those creditors who had not challenged the refinancing agreement.

The **practical effects of the declaration of a breach of the refinancing agreement (whether it has been homologated (*homologado*) or not)** have been regulated in greater detail (sections 629 and 630):

- The declaration of breach will result in the termination of the agreement and the disappearance of its effects, entitling creditors to file for a declaration to open insolvency proceedings or initiate enforcement proceedings.
- If the agreement contains a provision that foresees, in case of breach, the termination of the pre-existing in rem security rights or those granted under the agreement, those in-rem security rights may not be enforced.



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