Newsletter

Ramón y Cajal ABOGADOS

Insolvency Law

Madrid, 24 October 2011

Legislation:

Law 38/2011, of 10 October, reform of Law 22/2003, of 9 July, on Insolvency, published in the Official State Gazette (*Boletín Oficial del Estado*) no. 245, dated 11 October 2011.

Comments:

This newsletter summarises the most significant aspects of Law 38/2011, which modifies the Insolvency Law (*Ley Concursal*, or "LC").

1. **Elimination of Article 5.3 and addition of Article 5 *bis*:**

   - Notification by the creditor may be to announce negotiations to gain support for a proposed arrangement; the novelty is that it may also mark the initiation of negotiations to reach a refinancing agreement. The judge will only ensure that the notification is on record.
   - When three months have elapsed after the notification, the insolvent debtor must apply for declaration of insolvency (within a period of one month) regardless of whether an arrangement or agreement has been reached, unless it is no longer insolvent. That is, if the insolvent debtor reaches an arrangement with its creditors within a term of three months, it is not obliged to apply for declaration of insolvency.

2. **New section on claw-back actions in relation to refinancing agreements (Art. 71.6).**

   - These agreements may not be rescinded provided that:

     (i) They significantly increase credit or the obligations are modified.
     (ii) The due date is extended.
     (iii) An agreement is reached in accordance with a viability plan.
     (iv) The agreement ends before the insolvency, and was subscribed with 60% of the liabilities.
     (v) There is a favourable report issued by an independent expert.
     (vi) The agreement is raised to public document status.

3. **Amendment to the Fourth Additional Provision**. Introduction of the "Approval of refinancing agreements" following the same lines as the well-known "Schemes of Arrangement." Now there is the possibility for the judge authorised in the insolvency to approve the agreement and extend the agreement's effects to all creditors provided that:

   (i) The agreement fulfils the requirements of Art. 71.6 LC,
   (ii) It was signed by banks representing 75% or more of the liabilities at the time of the agreement.

(iii) It does not imply a disproportionate sacrifice for the creditors who do not sign it.

With regard to the processing of the approval of refinancing agreements:

- The insolvent debtor handles the application for approval and may request and agree to suspend the summary enforcements currently being processed.
- The Judge may agree to freeze the enforcements promoted by the financial lenders for the waiting period foreseen in the agreement, which may not exceed three years.
- In the 15 days following publication of the decision that approves the agreement, the creditors that did not sign it may challenge the approval only in two cases: (i) If quorum is not reached or if, in its own opinion, (ii) the sacrifice is disproportionate.
- Approval will not prevent financial institutions to uphold their rights *vis-à-vis* the parties obliged jointly and severally with the insolvent debtor and *vis-à-vis* their guarantors and financial backers.
- In case of non-compliance, any creditor may make such circumstance known before the Commercial Court (*Juzgado Mercantil*) by communicating an insolvency event. If the event is declared as non-compliant, there will be no possibility to appeal.
- If a debtor applies for approval of an agreement in accordance with the new Additional Fourth Provision, it may not request another approval before one year elapses.
- Fifty percent of the credits representing new treasury earnings or which have been awarded within the context of a refinancing agreement, under the conditions foreseen in Article 71.6 LC, will be considered credits against the insolvency estate.

4. Other new features:

- Incentive for involuntary insolvency proceedings (*concurso necesario*): Involuntary insolvency proceedings will be declared by the corresponding commercial court judge on the day after it is requested, if the creditor justifies the existence of a seizure or an investigation of unprofitable assets (Art. 15 LC). In addition, the percentage is increased from 25% to 50% of the assets belonging to the creditor that initiates the involuntary insolvency proceedings, which will be considered a generally privileged creditor (*privilegiado general*) (Art. 91.7).
- Modification of Art. 43.2 *"Conservation and management of the insolvency estate"*: the insolvency administrators may carry out drawdowns in the interests of the insolvency when necessary to guarantee the equity's viability necessities (court authorisation is not required, it must only be notified).

- The sale of assets which are not essential to the activity is permitted if the value of the assets in the inventory substantially coincides (real estate assets, a difference of less than 10% and in movables, less than 20%).

- The possibility of lifting the seizures established prior to the declaration of insolvency is expressly contemplated under law.

- The authority to determine the degree to which an asset is necessary to the activity and the necessity of said asset corresponds to the judge presiding over the insolvency proceedings.

- Summary enforcements already initiated will be suspended in any case, even though auction announcements may have been published. The suspension will only be lifted when a decision is handed down by the insolvency judge declaring that the assets or rights are not attached or are not necessary for the continuity of the insolvent debtor's professional or business activity.

- If the acquisition of a credit, following declaration of insolvency, occurs due to a forced disposal carried out by a financial institution, its owners will not lose their voting rights.

- Addition of a new category of credits against the insolvency estate: 50% of the credits that represent new equity earnings and are granted in the context of a refinancing agreement.

- Modification of Art. 155 LC: *"Payment of credits with special privileges"* General rule for the disposal of assets and rights attached to credits with special privileges: auctions. Exception: upon request or within an arrangement, the direct sale is permitted in favour of a preferred creditor or to the party it designates provided that the entirety of the credit is used. Outside of the arrangement: the bidding party must pay a price higher than the minimum and pay in cash.

- Notification of credits: Notifications must be addressed to the insolvency administrators, preferably by e-mail. In the interests of avoiding challenges that delay the proceedings, the insolvency administrators will send the creditors an inventory project and list of creditors 10 days before the deadline. The creditors may request that errors be corrected or information added until three days before the deadline.

- Streamlining of the common stage (*fase común*): If the challenges affect at least 20% of the assets or liabilities of the insolvency estate, the judge may order the finalisation of the common phase without prejudice to the challenges that may be reflected in the final texts or that may be agreed upon interim measures to guarantee their effectiveness.

- It is now possible for groups of companies to be handled in the same insolvency proceedings although this does not imply the consolidation of insolvency assets and liabilities of each group company.

- Reduction of the costs of insolvency proceedings by limiting the number of insolvency administrators. The general rule will be that insolvency proceedings, whether ordinary or abbreviated, will have just one insolvency administrator. This administrator must be a practising lawyer, an economist, hold a degree in business or be an auditor, and in all cases have five years of demonstrable professional experience. He/she may also appoint a legal entity which includes at least a practising lawyer and an economist.

- There will only be two insolvency administrators in the following cases:

  (i) Insolvency proceedings of an entity which issues securities o derivatives that are listed for trading on a secondary official market. In this case, a member of the technical personnel of the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores*, or "CNMV") will be appointed.

  (ii) Insolvency proceedings of a credit entity or insurance company. The insolvency administrator will be proposed by the Deposit Guarantee Fund (*Fondo de Garantía de Depósitos*) or by the Insurance Compensation Consortium (*Consorcio de Compensación de Seguros*) depending on the nature of the insolvent entity.

  (iii) In cases of ordinary insolvency proceedings of special importance (annual turnover and liabilities exceeding 100,000,000 Euros, more than 1,000 creditors and more than 100 workers): in this case, the judge will appoint an insolvency administrator who is a creditor owning ordinary credits or with general privileges from those appearing in the first third. A legal representative for the workers may also be appointed, if the workers' credit falls within the first third of the highest amounts.

- Regulation of insolvencies with no assets: There is now the possibility of concluding the proceedings when it is declared by the insolvency administrator, at any time, that there are no assets to address credits against the insolvency estate.

- Modifications to the abbreviated proceedings: The judge will apply abbreviated proceedings (reduced terms) when he/she considers that the insolvency does not present special complications, considering whether the following circumstances concur: the list presented by the insolvency debtor includes fewer than 50 creditors, the initial liabilities do not exceed five million Euros and the valuation of the assets and rights does not amount to five million Euros.

- As a general rule, whenever a preliminary proposal for insolvency restructuring or liquidation arrangement is presented, abbreviated proceedings will be followed, streamlining processes in order to end the proceedings swiftly.

5. Entry into force.

The entry into force will take place on 1 January 2012 except for certain articles that will enter into force on 12 October 2011. The latter include:

(i) New Article 5 *bis*, which substitutes 5.3;

(ii) New Article 15, which refers to involuntary insolvency proceedings;

(iii) Claw-back actions with respect to refinancing agreements.

(iv) The new forecast of credits against the insolvency estate of 50% of the amounts contributed in the "fresh money" refinancing agreements.

(v) New Fourth Additional Provision, governing the approval of refinancing agreements affecting financial institutions.

For more information

Ramón Fernández – Aceytuno
rfernandez@ramoncajal.com
+34 91 576 19 00
+34 608 57 80 05

Pedro de Navasqüés
pdnavasques@ramoncajal.com
+34 91 576 19 00