

OUT OF COURT DEBT RESTRUCTURING IN SPAIN A MODERNISED FRAMEWORK

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ABSTRACT

In Spain, the legal framework to solve the financial distress of businesses was confined to formal insolvency proceedings until recently, a number of reforms, have created a menu of options to tackle the problem out of court. The deficient results offered by formal insolvency proceedings in practice make this change commendable. The choice of out of court solution will depend on the type of debtor as well as on the kind of measures needed to bring the business back to solvent trading. The most complete, versatile and practically relevant of the new procedures is the Homologated Refinancing Agreement. Through this vehicle, troubled-but-solvent or insolvent debtors (and groups of debtors) may restructure its business, refinance its debt or bail in its shareholders, with a minimal Court intervention. Although the design of the procedure is subject to improvement in a number of ways, it has already been used successfully to restructure a several highly relevant market participants, many with an important international component. It remains to be seen whether large corporations seeking to solve their financial distress will continue to consider buying an –economy class- ticket to England with a view to reach a scheme of arrangement with its creditors.

I. INTRODUCTION

Arguably, the success of the schemes of arrangement of the British Companies Act 2006 (arts. ---)¹ lies in a combination of legal flexibility in their design and an excellent institutional framework for its implementation. On the

¹ On the origin of the schemes of arrangement, their regulation and practical implementation, see, for all, J. PAYNE, *Schemes of Arrangement. Theory, Structure and Operation*, Cambridge University Press, 2014, *passim*.

one hand, the schemes are a very flexible instrument, available even to non-insolvent companies, and with an open content that may lead to the restructuring of a business, a restructuring of the debt, a combination of both, or even to a liquidation of the entity; on the other hand, the problems that may arise under the use of the schemes (for example, issues of protection of minority creditors and/or shareholders) are tackled by a number of controls and tests that are to be applied by technically prepared judges, arguably with unrivalled experience and understanding of commercial matters. These features have attracted a number of high profile restructuring cases to the United Kingdom, some salient ones from Germany, the Netherlands or Spain ².

After more than 100 years with a system that combined a classic XIX century Commercial Code liquidation procedure (*Quiebra*) with a reorganization procedure (*Suspensión de Pagos*) enacted temporarily to avoid the liquidation of the *Banco de Barcelona* in the early XX century, Spain passed a relatively modern Insolvency Law in 2003, which came into force in September 2004. The system, partially the result of a number of failed previous attempts of reform ³, partially influenced by the German *Insolvenzordnung*, offered several possibilities to restructure the debt, all of which were to be conducted –totally or partially- in Court. A victim of the failure of a previous system that was hardly ever used, the Spanish legislator included a duty to file, triggered by illiquidity, with a view to ensure a widespread use of the new procedure. The arrival of the American financial crisis to the European banking system caught Spain at the peak of a real estate bubble and Spanish banks over-indebted and unable to refinance their debts. Banks drastically cut the financing to the real estate sector and hundreds of companies, directly or indirectly related to the real estate market, were forced to file for insolvency. Courts were faced with thousands of cases to apply an almost brand new law, with insufficient support from the still underdeveloped insolvency profession, incorporating new concepts they had little experience with/understanding of, and all of that with a relatively poor infrastructure ⁴. The almost immediate result was a poorly functioning insolvency system, unable to preserve value, with all but a handful of cases ending in piece meal liquidation.

² See, for example, the cases of the “Codere Group”, “La Seda de Barcelona, SA”, or “Metrovacesa, SA”, only to mention some (COMPLETE QUOTE); in Germany, well known examples would be the “APCOA Group”, “Rodenstock” or the “Equitable Life” Insurance; in the Netherlands, see the “India Kiath” case ----).

³ Before the Insolvency Law of 2003 (*Ley 22/2003, de 9 de Julio, Concursal*) (hereinforth “the insolvency Law” or “IL”), full insolvency drafts to enact a new system were produced in 1959, 1983, 1996, 2000 and 2002. The Initial version of the Insolvency Law was directly influenced by the texts of 1996, 2000 and 2002. It can be said that, to a certain extent, the IL, before the amendments, suffered from heavy “path dependency” of legal texts that were never in force.

⁴ An overview of the problems of Spain’s insolvency system at the time of commencement and during the financial crisis can be read at the consecutive IMF’s Article IV reports on Spain. These can be accessed at <https://www.imf.org/external/country/esp/>.

In this context, the Spanish legislator went on a reforming spree: from 2009 to 2015, Spain amended its Insolvency Law 8 times, 5 of which including major amendments⁵. While the reforms affected different parts of the Law, the most important ones –and the ones relevant to this paper- concerned, directly or indirectly, out of court solutions: a period of time to negotiate agreements was expanded and its effects strengthened; protection from avoidance actions was introduced for restructuring agreements that met certain requirements; and two types of out of court collective proceedings were created. The result is a complex but relatively comprehensive list of options to tackle the distress of financially troubled businesses. A choice menu for market participants to select the option that best accommodates their interests. Instead of one, flexible solution, the Spanish system offers a number of pre-defined paths to restructure viable businesses.

This paper will provide a full overview of the different existing options to restructure troubled but viable businesses, although it will concentrate on the one that more closely resembles schemes of arrangements, or, more precisely, on the one that might compete with its British counterpart. The reader of this paper should acquire enough information to decide if, under the new regulation of Spain's insolvency system, it still makes sense to shop for a different forum. The paper is structured as follows: first, an overview of the different proceedings will be provided (II); this will be followed by a description of the use of the different restructuring options in practice (III); and finally, a detailed analysis of the most complete and adequate out of court procedure will be provided, both from a national and international perspectives.

BUSINESS AND DEBT RESTRUCTURING IN SPAIN: AN OVERVIEW OF THE OPTIONS

In this paper, unless expressly stated otherwise, reference to a restructuring imply both debt and business restructuring⁶. The current legal framework in Spain offers different channels to conduct the restructuring of a distressed debtor. For the sake of clarity, I have divided them into three groups, depending on the degree of regulation and court intervention: (i) purely contractual agreements; (ii) regulated collective agreements; and (iii) in court insolvency proceedings.

⁵ Vid. Royal Decree-Law 3/2009 of 27 March 2009; Act 38/2011 of 10 October 2011; Royal Decree Law 6/2012 of 9 March 2012; Act 1/2013 of 14 May 2013; Royal Decree Law 14/2013 of 27 September 2013; Royal Decree Law 4/2014 of 7 March 2014; Royal Decree Law 11/2014 of 5 September 2014; or Royal Decree Law 1/2015 of 27 February 2015.

⁶ By the term “rescue”, however, reference is being made to the preservation of a viable business as a going concern through any of the avenues provided by the Spanish system. Naturally, a rescue may entail a debt and/or a business restructuring.

It is worthy of note that, in Spain, financial creditors are not secured with floating charges and the alternatives are poor substitutes for it (ie, they are not apt to achieve the same degree of control over the business in case of default)⁷. This bears consequences in the approach of debtors and its financial creditors to tackle financial distress⁸. Further, Spain does not count on a central bank-led active policy of promoting good debt recovery practice. No London Approach or similar type of scheme has been implemented among the Spanish banks and only reality (ie, a risk of to their own balance sheets and the excessive accumulation of assets and property over shares) has forced banks to cooperate actively in the rescue of viable businesses. There is no written code of conduct for debt recovery in the Spanish financial sector (except for a number of rules affecting mortgage debtors and the management of NPLs for the poorer debtors). All of these factors need to be taken into consideration to gauge the adequacy of the out of court procedures created by the recent reforms in the country.

2.1. Purely contractual agreements

The restructuring may be worked through a contractual agreement with one or more creditors. The debtor is free to pursue this path at any time and to seek a restructuring that is tailored to its needs. The advantages of this solution are many: flexibility in the negotiation, absence –or limited- reputational damage, no institutional cost and a design of the agreement only limited by the general legal framework. In Spain, both the regulation of contracts (generally, in the Civil Code), Company Law and the banking regulatory framework conform an adequate enabling set of rules for a contractual restructuring of a troubled debtor. In practice, these agreements are common, so long as the debtor finds itself at the early stages of financial distress.

However, there are limits to its use. The most evident limit is time: Spain's Insolvency Law (art. 5) includes a duty to file for formal proceedings within two

⁷ Spain does count on a “floating mortgage”, which is limited to immovable property (and is therefore nothing like the British floating charge). Substitutes –albeit poor substitutes, for different reasons- would be the “hypothecation of business” (*hipoteca de establecimiento mercantil*) or the pledging of the debtor's shares (in this latter case, the similarity merely rests on the fact that, like with floating charges, the maximization of the value of the business benefits the interests of the debtor and his secured creditor alike and in the same degree).

⁸ For decades, financial institutions would lend against security over fixed assets (mainly mortgages over immovable property). Also for decades, the real estate sector grew steadily in the country. Under these circumstances, financial creditors had little incentive to participate in the business restructuring of its debtors. It was only when the financial crisis came and banks had to acquire –as payment- large amounts of real estate assets that the fixed security was no longer a sufficiently attractive solution, and professional lenders had to start cooperating in the rescue of financially distressed debtors.

months from the onset of the state of insolvency (ie, cash flow or balance sheet test insolvency). This means that purely contractual solutions are no longer an option as insolvency gets near, since, otherwise, the debtor finds itself in a very poor bargaining position and the time to negotiate is very short⁹. Further, purely contractual solutions face the usual disadvantages of non-collective solutions to a collective action problem. The Civil Code (art. 1257) enshrines the principle of privity of contract, and as a consequence only those creditors participating in the agreement will be bound by it.

Since the entry into force of the current Insolvency Law, and until its first round of reforms, contractual agreements were the only out of court solution. Given the poor reputation that formal insolvency proceedings had earned for themselves during decades of value-destructive practice, it was relatively common for debtors to bilaterally try to reschedule the debt and for creditors to agree with a view to avoid going to court. However, certain peculiar characteristics of Spain's insolvency system, coupled with a stern judicial interpretation of the Law in the initial years, jeopardized out of court restructuring practice. Two elements of Spain's Insolvency Law influenced the ex ante behavior of creditors: on the one hand, the risk of subordination of those creditors who had entered into restructuring operations that would be found detrimental to the estate or to creditors (preference) and avoided in a subsequent insolvency procedure; on the other, the risk of being found "accomplice" of the debtor for having caused –or aggravated– the situation of insolvency as a consequence of a contractual out of court agreement that had proved unsuccessful. Although the latter was very exceptional, even in the "rough" initial years of judicial interpretation (when both debtors and creditors open to negotiate were seen as all but suspicious of colluding), the successful avoidance of restructuring agreements constituted a very real risk¹⁰, and creditors (ie., financial creditors) were often reluctant to negotiate deals, specially in cases where they already enjoyed some kind of security right. The main reaction of the legislator, in the 2009 and 2011 reforms, was to create a system of protection of out of court agreements whenever certain requirements were met¹¹. These were the initial version of what we call "regulated collective agreements" (see below ----).

⁹ The two months to file for insolvency (ie, to negotiate an agreement) would run from the moment the debtor knew, or should have known, that she was insolvent.

¹⁰ Following a landmark decision by the First Commercial Court of Madrid [...\(Case Spirito Santo\)](#)

¹¹ A thorough analysis of the different legal instruments created to protect restructuring operations from ex post avoidance actions can be read in the works of Professor J. PULGAR, who successfully imported the Italian expression of "protective shields" to describe the legal effect. In this regards, see J. PULGAR, "Estrategias preconcursales y refinanciaciones de deuda: escudos protectores en el marco del RDL 3/2009", in A. Alonso/J. Pulgar (dirs.), *Implicaciones Financieras de la Ley Concursal*, Madrid (La Ley) 2009, pp. 49 et seq.; and

Further, in 2015 the legislator introduced, for the first time, a system of protection of out of court, contractual, *non-collective agreements* from ex post avoidance actions. The regulation is included in article 71 bis of the Insolvency Law. In order to be protected against avoidance actions, the agreements needs to comply *all* of the following requirements: (i) the proportion between the assets and liabilities must be increased; (ii) following the agreement, the working capital has to be positive ¹²; (iii) the value of the security rights created in favour of the participating creditors does not exceed 90% of the value of the debt outstanding with the said creditors; (iv) the proportion of security rights to debt held by the participating creditors is not increased as a consequence of the agreement; (v) the interest rate applicable to the debts following the restructuring operation has not increased more than 33% of the previous interest rate; and (vi) the agreement, including a justification of the measures adopted, is formalized by public deed before a notary public. As it will evident to the reader, the law offers protection to agreements whose content is so obviously positive for the debtor (and non-participating creditors) that there is no reason to keep it on the line, subject to the risk of a future annulment ¹³.

2.2. Regulated collective agreements

The reforms to the Insolvency Law of 2013, 2014 and 2015 introduced to the Spanish system a new set of out of court solutions to the financial distress of business ¹⁴. Two of the solutions are open to any debtor, and one is designed to tackle the financially troubled small and medium enterprises (SME). I will briefly

“Preconcurso y acuerdos de refinanciación”, in *Revista de Derecho Concursal y Paraconcursal* nbr. 14 (2011) pgs. 25 et seq.

¹² Article 71bis.2 literally states that the liquid assets (*activo corriente o circulante*) are equal or higher than short term liabilities (*pasivo circulante*).

¹³ But it is questionable whether this new protection is anything more than an attempt to generate additional certainty to the financial creditors with a view to fostering out of court agreements. In reality, it would seem difficult to see how an agreement of the type described in the Law could ever be avoided in a subsequent insolvency, under the law existing before the reform, since no damage to the estate or detriment to creditors would seem to likely arise.

¹⁴ Spain got ahead of the European Commission. When EC Recommendation on a New Approach to Business Failure and Insolvency of 12 March 2014 was passed, Spain had already implemented a number of measures aimed at achieving the result sought by the said recommendation. The Spanish reform was not directly related to the financial assistance provided by the European Stability Mechanism for the recapitalization of Spanish Banks. Even if this assistance was channeled through a Memorandum of Understanding that included a number of measures that were not directly related to the financial sector, insolvency law was not a direct target. However, it did have an indirect relationship. In part, the reform would seem to follow –slowly, dragging the feet– the recommendations of the IMF’s Article IV Consultations (see the recommendations on Spain for 2012-2015, available at <https://www.imf.org/external/country/esp/>).

describe all three of them. A thorough analysis of the one that more closely resembles schemes of arrangement will be included in section ---- below¹⁵.

All of these three agreements may benefit from a preparatory stage, which has been labeled as “*negotiation period*” or generally as “*article 5 bis moratorium*”. If the debtor is insolvent, and with a view to suspend the time to mandatorily file for insolvency, the debtor may communicate the Court that negotiations have been commenced to reach any of the three types of collective out of court proceedings described in this section, or even to negotiate an in-court anticipated insolvency plan. This communication is a formal requirement, and there is only a superficial control that the legal requirements are met¹⁶. From that moment on, the debtor has three months to negotiate the agreement, after which, in the absence of agreement, insolvency must be filed within one more month (unless, obviously, the business is not insolvent)¹⁷. During the negotiation period, no foreclosure or executions can take place over the assets and rights of the debtor, with the exception of those used as collateral in favour of a secured creditor that are not necessary for the continuation of the business activity. This temporary stay does not affect public creditors, who can freely seize assets and freeze accounts¹⁸. During the moratorium, no creditor may successfully file for the debtor’s insolvency either.

¹⁵ The expression “Refinancing Agreements” is a literal translation of the Spanish expression “*Acuerdos de Refinanciación*”. The use of the term “refinancing” is misleading. Both types of the collective out of court agreements regulated in Spain include the possibility to refinance (ie, reschedule or replace the debt for a different loan with a later maturity), but also to restructure the debt by reducing its nominal, its interests, or indeed by amending any other condition of the initial financing agreement.

¹⁶ There is no analysis of the merits of the petition, and the judge does not need to see evidence of the debtor’s insolvency.. The Judge must, however, check that the COMI is in its jurisdiction, because the negotiation period of art. 5 bis IL is included in Annex A of the Recast EU Insolvency Proceedings as one of the types of Insolvency Proceedings existing in Spain.

¹⁷ This is the literal and more widely supported interpretation of article 5 bis. However, there are authors that contend that after the 3 months the –insolvent- debtor must petition for the opening of formal insolvency proceedings immediately (or else become subject to the consequences for the infringement of the duty to file). For the majority opinion, see ---- ; for the latter interpretation, see ---- .

¹⁸ The exclusion of public creditors from the moratorium is another step in the path initiated by the legislator to overprotect public creditors since the onset of the financial crisis. With the –erroneous- view that repayment of public claims ahead of private creditors protects the public interest, Spain has slowly amended the original version of the Law, reasonable in its initial version, to place public claims ahead of the rest (using the financial crisis, and the need to increase the revenues of the State, as alibi). And it has done so by providing public claims with a procedural privilege: essentially, by leaving them untouched in all types of out of court agreements. The consequence of this is, naturally, that the restructuring effort is borne by private creditors, while public claims are paid in full. It also hampers the successful completion of an out of court agreement, since public claims are only classified as 50% ordinary and 50% generally privileged in the hierarchy of claims within ordinary insolvency proceedings. If the amount outstanding is large enough, private creditors may be better off inside formal proceedings.

In 2014, the legislator took a step further to incentivize the use of refinancing agreements (Types I and II) by softening the regulatory framework of banks. Credits that have been subject to a refinancing agreement may be re-classified as “risk normal” in so far as there are objective elements that deem the payment of the amounts owed under the agreement as probable¹⁹. The rule is very “generous”, since it expressly states that, in order to assess the increased probability of repayment, the write-downs and additional time to repay have to be taken into consideration; and, more importantly –and also more controversially-, the reclassification may be executed from the very moment of formalization of the refinancing agreement: there is no need to wait a prudential period of implementation to lower the risk in the bank’s balance sheet. The importance of this measure cannot be overestimated in a country where the banking system has recently undergone a severe crisis.

The following paragraphs contain a brief summary of the main characteristics of the 3 types of out of court, collective proceedings²⁰.

- **2.2.1. Regulated collective proceedings Type I: -Ordinary- Refinancing Agreements (*Acuerdo de Refinanciación*).**²¹ - These agreements are purely conducted and implemented out of court, with no formal institutional involvement (ie, no insolvency representative or mediator is appointed). They can be reached by any type of debtor with any type of creditor (although some restrictions apply to public creditors), and there is no express requirement that the debtor be insolvent or even imminently insolvent. The Law promotes these agreements by offering protection in two different stages: first, as described above, during formal negotiations; second, once approved, if the debtor falls insolvent the agreement is sheltered from avoidance actions. In order for the refinancing

Practice shows that the most hazardous measure of all happens at the onset of the “negotiation period”. Once a debtor gives notice of the commencement of negotiations, the Tax Agency is notified by the Court. Since it is not subject to the moratorium, the public claimant avails itself of the period to seize assets and get *de facto* priority over receivables and other rights of the debtor, endangering the continuation of the business and the restructuring agreement as a consequence thereof. Fortunately, this is not always the case. Sometimes the tax authorities simply use the threat to reach a bilateral agreement whereby the main bulk of the debt is rescheduled, against the payment of an initial lump sum and the provision of additional security/guarantees.

¹⁹ The regulation is contained in the Additional Rule 1 of the Royal Legislative Decree 4/2014 and developed by the Bank of Spain in its Regulation (*circular*) 4/2014, of 18th March 2014.

²⁰ For a detailed description and analysis of these procedures, see the thorough work of Professor J. PULGAR, *Preconcursalidad y Reestructuración Empresarial*, Madrid (La Ley/Wolters Kluwer) 2016, 2nd ed., passim. For more recent analysis, focused on type II of collective refinancing agreements, see also F. AZOFRA, *La Homologación Judicial de Acuerdos de Refinanciación*, Madrid (Reus) 2016.

²¹ Hereinforth, “Refinancing agreements” or “Type I agreements”.

agreement to benefit from the protection against avoidance actions, a number of requirements must be met. In short, the Law requires one material and three procedural requirements (art. 71bis.1.b)). The mandatory material content of the agreement consists of a “significant increase of the funds available” or the rescheduling or writing down of the debts, measures that must be linked with a business viability plans that allows for the continuation of the activity in the short and mid-terms. The procedural requirements are the following: (a) 3/5 of the total claims support the agreement (all creditors of a syndicated loan will be deemed to support the agreement if creditors representing 75% of the loan have voted for it; and loans provided by companies of the same group are excluded); (b) an auditor (the one of the company or one appointed ad hoc if there was not one in office) certifies that the required majority has been reached; (c) the agreement and all necessary documents have been notarized.

- **2.2.2. Regulated collective proceedings Type II: Homologated Refinancing Agreements (*Acuerdo de Refinanciación Homologado*²²).**- These are refinancing agreements between the debtor and its “financial creditors”, not including commercial or tax creditors. Type II agreements are, essentially, a Type I refinancing agreement that is made binding on non-participating/dissenting creditors, even on those holding security rights, following confirmation by the Court that certain requirements have been met. No insolvency representative is appointed and the Court intervention is limited to the decision on the commencement of the negotiation period (if formally notified to the Court, something which is not mandatory) and to the confirmation of the plan. Apart from the enhanced efficacy vis a vis creditors, the Law also envisages a stay of executions during the period that lapses from the petition to confirm the plan and the issuance of the decision, and absolute protection from ex post avoidance actions. Although these agreements are open to all kinds of creditors, practice shows that they are mainly used by mid to large businesses. In fact, this mechanism has been used in a number of high profile cases in the past two years. Albeit different, they constitute the more likely alternative to the schemes of arrangement and will be analyzed in detail in section IV below.
- **2.2.3. Regulated collective proceedings Type III: Out of Court Agreements on Payments (*Acuerdo Extrajudicial de Pagos*)²³.**- This full out of court procedure is designed for insolvent –and only insolvent-

²² Hereinforth, “Homologated refinancing agreements”, “Type II Agreements” or “HRA”.

²³ Hereinforth also “Type III Agreements” or “OCAP”.

SME ²⁴. Its introduction in the 2013 reform sought to provide a solution to distressed small businesses outside the Court system, then already struggling with a backlog of cases. It consists of a relative nimble procedure, with limited paperwork required and the use of pre-designed templates, channeled through the Commercial Registry and Chambers of Commerce ²⁵, with the intervention of insolvency professionals labeled “mediators” (*mediador concursal*) but whose role stretches well beyond mere mediation. The initiative is assigned only to the debtor, who triggers the commencement of the procedure by requesting from the Commercial Registry of its domicile or an authorized Chamber of Commerce to appoint a mediator. Once checked that all formal requirements are complied with, a mediator is appointed from a list, in pre-established order. The appointor will notify the Court of the commencement of the negotiation period and a stay of executions will commence, with the same scope and time as already described for refinancing agreements Type I and II. The mediator will check the documents submitted by the debtor and contact creditors, summoning them to a meeting within 2 months from the appointment. All creditors are involved in this procedure, with the exception of public creditors. The mediator will draft a plan, agree it with the debtor and share it with creditors ahead of the meeting. The content of the plan is open and flexible, although the majorities required increase with the hardship of the plan. If passed, the agreement binds also non-participating and dissenting creditors, including secured creditors ²⁶, and the agreement cannot be avoided in a subsequent insolvency.

2.3. In-Court insolvency proceedings

The Insolvency Law envisages three possible exits: an “anticipated insolvency plan” (*convenio anticipado*); an –ordinary- “insolvency plan” (*convenio concursal*); or a liquidation, which can take place through a sale of the business –or business units- as a going concern or on a break up basis. The Law expressly declares its preference for the plan (in any of its modes), and, when not possible, for a going concern liquidation. Following the steps of the German *Insolvenzordnung*, formal insolvency proceedings feature a unitary approach:

²⁴ The debtor may be a sole entrepreneur or a legal entity with an estimated debt of less than 5 million euro (art. 231 IL).

²⁵ Individual debtors who are not entrepreneurs will trigger the procedure through a Notary Public (---), that may also act as mediator.

²⁶ The Law tackles the passivity of creditors, common in the insolvency of SMEs, in a stern fashion: those creditors that have been notified and have not attended the meeting or otherwise supported or rejected the plan expressly will suffer the subordination of their claims in case of subsequent insolvency proceedings (art. 237 IL).

every procedure has a common stage, in which the relevant information on the business, its creditors and the causes of insolvency is collected, analyzed and presented to creditors, so they can make an informed decision on the destiny of the business; the procedure follows with the opening of either a reorganization stage, aimed at the approval of a plan, or a liquidation. In every case insolvency proceedings are based on actual or imminent insolvency²⁷, an insolvency representative is always appointed, a rigid procedure is applicable and the entire process is conducted in Court. Any comparison with the schemes of arrangement of the UK would seem too far-fetched (rather, they would be more similar to an *administration* or to *winding up* proceedings).

This is also true of the “anticipated insolvency plan” exit. This type of insolvency plan was designed as a pre-packaged plan²⁸, that would be negotiated out of court but quickly plunged in formal insolvency proceedings through an expedited path, to make it binding on all creditors and safe from avoidance actions. The debtor may present the plan with the petition to open insolvency proceedings or in a short period thereafter, together with the formal support of creditors representing 20% or more of the total debt; and the procedure leading to its approval by creditors takes place within the initial, “common stage”. But that is as far as the specialty goes. For virtually every other aspect, the “anticipated insolvency plan” is a full, in-court solution, with all the negative consequences of formal procedures. The procedural terms envisaged in the law are hardly ever complied with, proceedings take too long and liquidation looms as a threat that scares both debtors and creditors alike. It is no surprise that this solution has been successfully implemented in very few occasions²⁹.

III. THE USE OF THE SYSTEM TO DEAL WITH BUSINESS FAILURE

²⁷ Note on imminent insolvency

²⁸ This type of plan has a hybrid nature, between contractual out of court solutions and in court proceedings. For the concept of hybrid proceedings, and the different typology, see J.M. GARRIDO, *Out of Court Debt Restructuring. World Bank Studies*, The World Bank, Washington DC, 2012, available at <http://elibrary.worldbank.org/doi/abs/10.1596/978-0-8213-8983-6>.

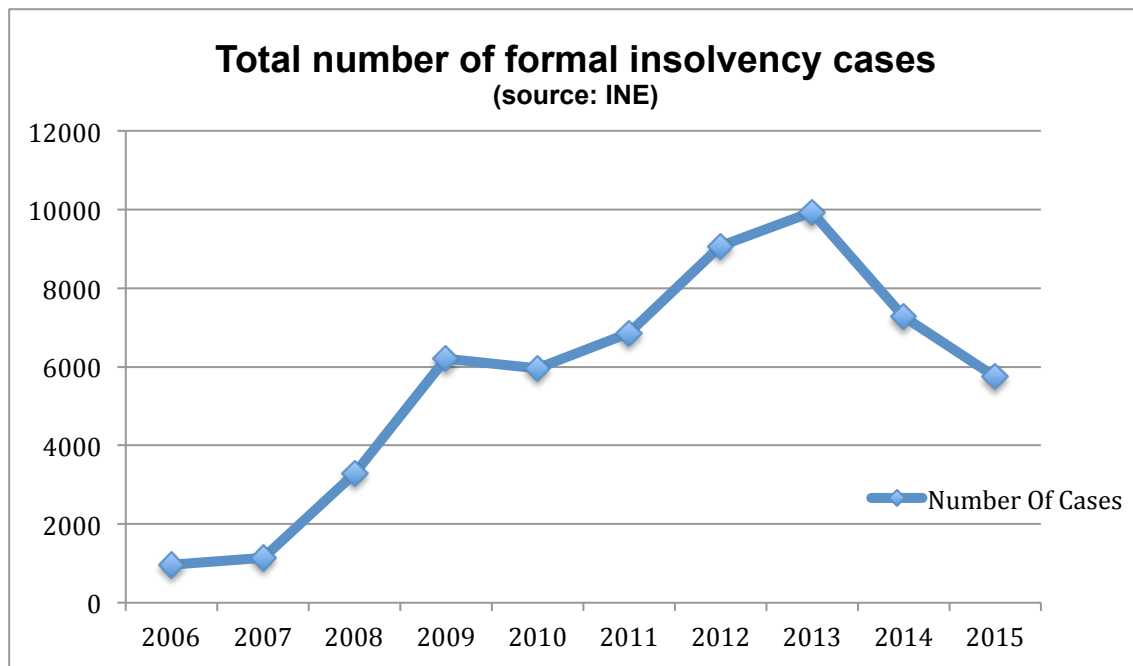
²⁹ For example, out of 5746 ongoing insolvency proceedings, only 19 anticipated plans were proposed; in 2014 the number was 16 out of 7280; although higher in the previous two years (113 out of 9937 proceedings; 134 out of 9071), the numbers still reflect a very low use of the mechanism (source: National Institute of Statistics (INE), available at www.ine.es). The time of completion of insolvency proceedings with anticipated plan is too long and in any case not respectful of the time sequence envisaged in the Law. For example, in 2015, the proceedings where an anticipated plan was passed, had taken 408 days until approval, as compared to 544 days for ordinary insolvency plan proceedings: source, “Anuario Concursal” of the Spanish Official Body of Registrars 2015: <http://www.registradores.org/portal-estadistico-registral/estadisticas-mercantiles/estadistica-concursal/>, pg. 78.

In the previous section I have purported to map out the different possibilities to restructure viable businesses in Spain. In this section, data will be provided as to the real use of the different options. Although the scope of this paper is limited to the regulated, out of court proceedings (which, incidentally, are the ones that present a closer similarity with the schemes of arrangement), the behavior of the parties in the Spanish market has to be understood and the assessment of the validity of the options conducted considering the benchmark of both purely contractual and formal insolvency proceedings, as their alternatives.

3.1. Formal insolvency proceedings: Basic data and reasons for its results

Figure 1 below shows an overview of the evolution of the use of formal insolvency proceedings in Spain, almost from the beginning of the current system. The graph shows a slow start in the use of insolvency proceedings, and a sharp increase since 2008, year in which the effects of the financial crisis started to kick in. At its peak (2013), the number of insolvency cases reached 9937, to start a relatively rapid decrease in the following years. Even considering the deep economic crisis suffered by the country, and the legal inclusion of stern measures to foster the use of the system (ie, a duty to file the breach of which would entail personal liability for company directors), Spain's in court insolvency system shows low numbers compared to other advanced economies³⁰.

³⁰ Vid. the higher numbers of the United Kingdom (94.594 cases, including companies and personal, in 2015; source: the Insolvency Service: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/495531/Q4_2015_statistics_release_-_web.pdf); France (41.474 new insolvency proceedings opened only in the first 9 months of 2016 (source Insol Europe: at <https://www.insol-europe.org/technical-content/national-insolvency-statistics-france>); or Germany (19.035 new businesses in Insolvency during 2015 -101.852 including individuals, both professional/entrepreneurs and consumers; source: D-Statist), all countries that did not undergo a crisis or not as severe as the Spanish crisis.



The reasons for the relatively scarce use of the system are diverse. One first reason is socio-economic: the stigma generally associated with insolvency proceedings. The traditional *personal stigma* associated with insolvency has no doubt been a factor relevant to explain the low use of the system in Spain, especially in the initial years. An element that is often present in most societies –and that constitutes a hurdle for most systems across Europe and beyond– had special intensity in Spain, a country where a punitive insolvency framework from the XIX century had been in place until 2004³¹. The reluctance to use insolvency proceedings was also based on its very poor perception by the market. For decades, insolvencies mostly ended with value-destructive, piecemeal liquidations. The modernization of the legal framework takes time to settle in the realm of insolvency³², and the market does not yet seem to perceive formal insolvency proceedings as an efficient instrument to preserve value. And there are good reasons for it. Numbers show that the current system takes too long and the recovery rate of creditors is low³³.

³¹ The old system provided for a number of automatic personal sanctions of the insolvent debtor: disqualification from the conduction of entrepreneurial activities, prohibitions to act as directors of companies, to be tutor, to access public service, etc. All of these sanctions were an automatic –and, in almost all cases, perpetual– consequence of the commencement of proceedings.

³² Explain and expand based on World Bank experience. Quotes

³³ The low use of the system may also be explained by the existence of more efficient debt collection mechanisms, especially for secured creditors (see M. GARCIA POSADA/J. MORA SANGUINETTI, “Are there alternatives to bankruptcy? An analysis of small business distress in Spain”, Bank of Spain, available at <http://rd.springer.com/article/10.1007%2Fs13209-014-0109-7>).

Exit to formal insolvency proceedings

(source: INE)

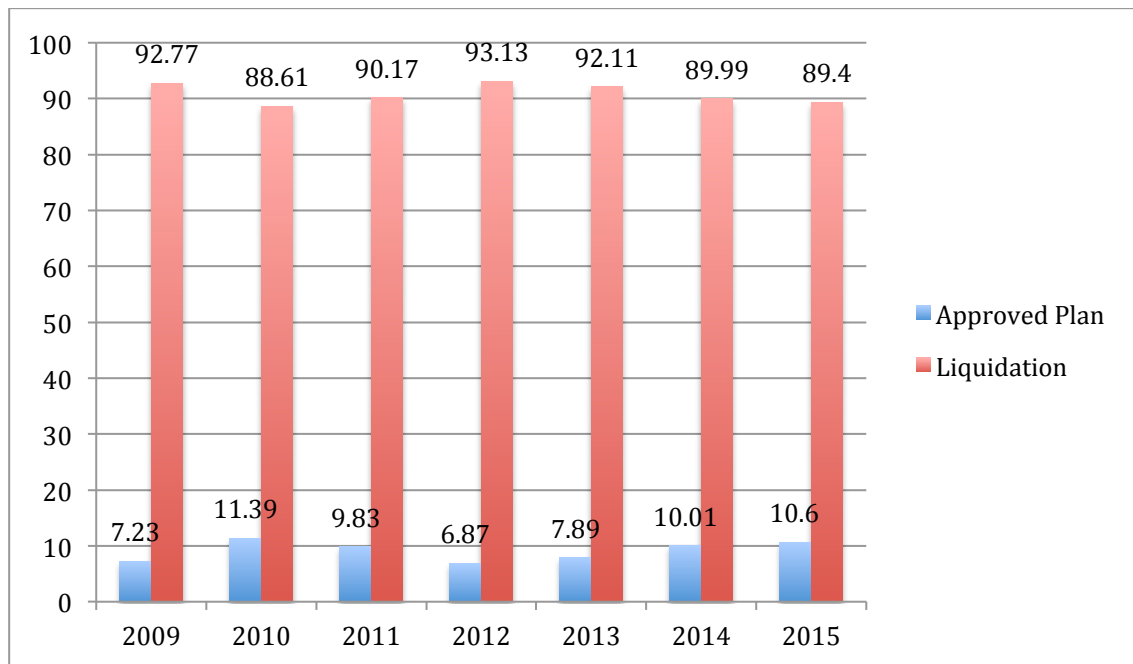


Figure II above shows that the vast majority of proceedings end in liquidation. The section in blue (an average of 9,04% of all insolvency cases in the past 5 years) refers to approved insolvency plans, including both ordinary and anticipated plans. Data also shows that the likelihood of the procedure ending with an insolvency plan increases with the size of the debtor³⁴. The percentage of recovery for participating creditors was 50,56% in 2014 and 51,68 % in 2015³⁵. Unfortunately –and somewhat surprisingly- there exists no data as to the

³⁴ In 2015, the size of the legal entities that were able to reach an agreement with creditors within formal insolvency proceedings had an average size three times larger than the average of those that were wound up (vid. “Anuario Concursal 2015”, Registrars, pg. 29).

³⁵ Source of the data: “Anuario 2015” and “Anuario 2014”, Registradores, op. cit., pgs. ---- . It must be noted that such percentage is relatively high, provided that priority creditors and secured creditors (for the part of the claim secured by collateral) are not bound by the insolvency plan, and, therefore, it can be presumed that a high percentage of them will be paid in full. However, the situation is worse than it seems at first sight. The percentage of recovery is in the area of 50% because, until the reform of the Insolvency Law of 2015, ordinary insolvency plans could only include a write down of the debt of up to 50% of the nominal value of the claims (in other words, 50% is the maximum relief that debtors were allowed to agree to if liquidation was to be avoided). Further, the number refers to the nominal write down, and does not take into consideration the rescheduling of the debt (up to 5 years, until 2015, up to 10 years, now), so the percentage does not incorporate the discount of the amounts as a consequence of the delay in paying. And, most importantly, the data concerns approved plans, not implemented plans. To the best of our knowledge, there exists no data on the percentage of insolvency plans that have been fully implemented. In any case, considering the existing data on liquidations commenced following a failure of the implementation of the insolvency plan, the number of failed plans is relatively high.

percentage of recovery in liquidation. Perhaps the most deluding characteristic of the system is its slowness. The law includes two types of proceedings: abbreviated and ordinary, depending on the size of the debtor or the amount of debt. The former includes shorter procedural time lapses and is supposed to be quicker and less costly. The vast majority of proceedings are abbreviated (88,5% in 2015). Times are, however, slow in both types. For example, in 2015: (i) the average time for anticipated insolvency plans to be passed, counting from the beginning of the procedure, was 408 days, in case of abbreviated proceedings and –somewhat surprisingly– 367 days, for ordinary proceedings; the procedure leading up to the approval of ordinary plans took an average of 544 days, in abbreviated proceedings, and 701 for ordinary proceedings; but the real problem lies with liquidations, where the time (just for the liquidation stage, not counting the common stage) stretched out to 485 days for abbreviated and 448 for ordinary proceedings in 2015³⁶. Too late.

The current malfunctioning of the system is possibly due to a few errors of the legal design, but mostly to the deficiencies of the institutional framework.

Although the Insolvency Law has improved substantially with the reforms, some salient problems still exist. This is not the place to dwell on formal insolvency proceedings, but it is worth only mentioning the most relevant shortcomings³⁷: (i) there exist breaches of the absolute priority rule, perhaps the most relevant being the ability of the debtor (ie, shareholders) to block the passing of a plan, even if the company is balance sheet insolvent; (ii) the law includes a convoluted class voting system, in which the different classes are not set by economic value but rather by “nature” of the debt (financial, labour, public, other creditors), where public creditors are thus protected and where there exists no cram down rule; (iii) the regulation of the effects of the opening of proceedings on executory contracts runs against international standards³⁸ by conferring the highest priority (administrative claim: *deuda de la masa*) to the counterclaim of the party *in bonis* of a disclaimed contract; and (iv) the 2015 reform, rightly, included the automatic transfer of contracts in case of sale of the business as a

³⁶ The average duration of the “common stage” in 2015 was 308 days for abbreviated and 377 for ordinary proceedings. In 2014, the numbers were quite similar: 366 and 379 days (source “Anuario 2015”, Registradores, op. cit., pg. 11).

Since the 2011 reform, it is possible to run the liquidation of the debtor during the common stage. This expedient liquidation is the solution for roughly ¼ of cases: 27,1% in 2015; 26,7% in 2014; 27% in 2013; and 21% in 2012.

³⁷ For a summary of the main deficiencies of the system, see C. De Long/M. Saiyid/ M. Balz/I. Tirado, “Spain’s Insolvency Regime: Reforms and Impact”, *IMF Country Report*, Selected Issues, No. 15/233, 2015; and C. De Long/ M. Balz/I. Tirado, “Strengthening the Insolvency Framework for Spanish SMEs”, *IMF Country Report*, Selected Issues No. 14/193. 2014.

³⁸ See Principle C9 of the World Bank Insolvency and Creditors’ Rights Principles (available at <http://www.worldbank.org/en/topic/financialsector/brief/the-world-bank-principles-for-effective-insolvency-and-creditor-rights>), based on the Recommendations of UNCITRAL’s Legislative Guide (available at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html).

going concern, but it also made it mandatory for the acquirer of the business to assume the outstanding labour debt, hampering going concern liquidations and altering the hierarchy of priorities envisaged in the law.

These shortcomings of the Law help understand the system's lack of perception as an adequate market instrument to restructure viable businesses by the market, but they are not the cause for its inefficiency. The main source of inefficiency and hence the main problem of the system lies with its implementation. Proceedings take too long and are too costly, due to an inadequate institutional framework.

The institutional side of Spain's formal insolvency system is composed of insolvency practitioners (*administradores concursales*), on whose shoulders rest most the tasks and duties of the procedure, and the Court. There are problems with both.

The Spanish market counts on a sufficiently deep market of specialized professionals to implement the system³⁹, but their activity is not properly regulated: the system of judicial appointment gave rise to controversy and has been substituted by an automatic appointment from a list which ensures that professionalization will cease to develop; the system of remuneration is flawed, with an excessive pay in the larger cases, an incentive to artificially lengthen proceedings in order to extend the perception of monthly retribution, and, specially, with no solution for cases where there are little or no assets even to pay the fees of the professional (a situation that generates passivity and lack of interest); and the mechanisms to implement the accountability of insolvency representatives are ineffective. All this generates uncertainty and lack of trust in the system by stakeholders.

Concerning the Court system, the problem –the most acute problem- is one of lack of adequate infrastructure. One of the most positive changes of the Insolvency Law of 2003 was the creation of specialized courts (*Juzgados de lo Mercantil*), competent to decide commercially related cases. The technical level of the judges has increased significantly, and a good reputation has been created⁴⁰. The problem of the Courts is not the judges that run it, not even the amount of judges available (which has been increased in the past years), but

³⁹ The system of insolvency representatives in Spain has improved significantly in recent years. Previously a closed system handled by a few, with limited professionalization, the profession is now well established, the technical level much higher, and transparency has improved (although there is still plenty of room for further improvement). Spain has not yet created a system of self regulatory organizations, but there are professional bodies, with codes of conduct and disciplinary procedures in case of malpractice. The system still is in need of further development.

⁴⁰ The creation of commercial courts has generated a body of highly skilled, technically prepared judges, whose decisions are now even quoted with the name of the judge (something unimaginable before, where no one knew the name of judges), as is common in Common Law systems.

rather the lack of means of the system. Files are not digitalized, and the IT system is old fashioned and insufficient to handle great amounts of documentation. Courts are engulfed with papers and documents; there is not enough administrative staff; and the buildings don't have enough rooms to hold oral hearings, causing massive delays as a consequence thereof. Judges have to face hundreds of cases with no support, since there is no system of clerks in Spain's procedural practice. The situation is made worse by a law that designs a system that is –still, despite the amendments- excessively rigid and procedural. The machinery is slow and cumbersome, and it cannot deal with the amount of work it has. Procedures last too long and this hampers the chances of rescue of the business.

3.2. Avoiding formal proceedings in practice: the use of out of court solutions

The foregoing depicts a formal insolvency system that stakeholders try to avoid. The legislator, aware of its malfunctioning, has tried to alleviate the backlog of cases by creating the disparate out of court proceedings. In the following paragraphs we shall briefly describe the use of the out of court solutions. In order to read the data correctly, two elements need to be borne in mind: firstly, there is no data available concerning purely contractual agreements or refinancing agreements Type I (ie, agreements that are protected from avoidance actions provided that certain requirements are met), which, we would assume, are the most commonly used; refinancing agreements Type II (judicially homologated) and out of court agreements on payments have been created recently, and therefore the data available only reaches out to two years and it only reflects the use of the system, but there is no data as to the efficacy of the agreements (since the vast majority of them should still be in the stage of implementation).

3.2.1. Regulated collective proceedings Type III: Out of Court Agreements on Payments

As it was stated above, these are proceedings designed to tackle the distress of SME. The access is limited to insolvent debtors, and therefore it is an alternative to formal insolvency rather than a mechanism of early prevention. Its aim is to free the court system from the smaller cases, by creating a streamlined procedure conducted by professional “mediators” and channeled through semi-public bodies, currently less burdened with work than courts.

The numbers that are available refer only to part of 2014 and 2015, and show the following ⁴¹: (i) There were very few petitions of legal entities (28 cases open in 2015); (ii) the entities were of small size (in 2014, the average value of assets of the debtors was of 377.632 euro, and 783.815 euro in 2015; the average amount of debts in 2015 was in the tune of 800.000 euro, with 82,35% of debtors owing less than 1 million euro, 11,76% between 1 and 2,5 million, and 5,98%, more than 2,5 million –and less than 5, the legal limit) and with a small volume of business (in 2015 no debtor undergoing this type of procedure had a business volume higher than 2,5 million euro); and (iii) the financial situation of the debtors at the moment in which they filed to use the system during 2014 and 2015 was highly deteriorated, in fact worse than the average financial distress of formal insolvency proceedings).

The very scarce use of Type III agreements is probably explained by a combination of a flawed design with a lack of insufficient dissemination amongst the owners and directors of the smaller businesses. The design fails specially in two elements: firstly, it leaves out public creditors (ie, tax claims), which cannot be bound by the agreement, in a sector where public claims often constitute the most relevant outstanding liability, rendering the procedure useless. In fact, the treatment of public claims within formal insolvency proceedings is more favourable to the debtor, since at least 50% of the tax claims are treated as merely unsecured claims, and default interests as subordinated. In light of this, smaller debtors have an incentive to use formal insolvency proceedings instead of its out of court alternative. Secondly, the system of majorities envisaged in the procedure is too stark. Having to reach such high voting thresholds constitutes a disincentive to debtors.

3.2.2. Regulated collective proceedings Type II: Homologated Refinancing Agreements

⁴¹ The sources are the “Anuario 2015” and “Anuario 2014”, Registradores, op.cit., pgs.124 et seq; and the Registry of Insolvency Decisions (*Registro de Resoluciones Concursales*), an open, public registry run by the Official Body of Property and Commercial Registrars (Colegio Oficial de Registradores de la Propiedad y Mercantiles). The website is <https://www.publicidadconcursal.es>.

Although this type of out of court procedure was introduced in 2013, the Ministry of Justice did not take the steps necessary for its implementation (among other, the publication of a list of mediators) until April 2014. The institutional system was not fully operative until October 2014 (vid. the analysis of the Professional Body of Economists of Spain, available at: <http://www.economistas.es/Contenido/REFor/ActualidadREFOR/CONCLUSIONES%20REFOR%20POR%20CCAA%20Y%20PROVINCIAS%20%20SOBRE%20MEDIACION.pdf>). The activity during those initial times and the rest of 2014 is almost irrelevant. The data provided only refers to legal entities. In 2014 and 2015, 42 individual entrepreneurs filed for a Type III agreement, and in 2015 the number increased to 396.

The data available about homologated refinancing agreements is very scarce: during 2015 (the first full year of availability of these agreements), 94 agreements were successfully homologated by the Courts; in 2016, the trend has kept steady, with 72 judicially confirmed agreements by 31 October (last date we have found data available) ⁴².

On the face of it, numbers would seem low. However, most of the cases concern medium to large companies, including some very large multinational groups, active in dozens of countries. Although a purely gross numeric comparison with the number of formal insolvencies offers a scarce use of the agreement (less than 2% in 2015), a comparison of the added value of the assets and liabilities involved in homologated agreements compared to those pertaining to formally insolvent companies, gives the out of court procedure a much higher relevance. The perception on the use of the system would also seem to be positive, for the upper tier of the market: although there are complaints (see below IV), the procedure is considered a much preferred alternative to formal insolvency proceedings. Allegedly, homologated refinancing agreements would be preferred over formal insolvency proceedings by most –if not all- medium sized to large companies/groups, as well as by their financial creditors (although the conviction is less strong for the latter: specially those with security rights) ⁴³.

IV. HOMOLOGATED REFINANCING AGREEMENTS

4.1. General considerations

As it will seem apparent from the description in the previous sections, the Spanish system of out of court solution to business financial distress does not include one complete solution: none of the type of proceedings available can be used by all debtors, bind all creditors or produce all possible results (reorganization, liquidation). Type one collective refinancing agreements simply

⁴² Source: the Official Gazette (*Boletín Oficial del Estado*, available at www.boe.es), and the Professional Body of Economists of Spain, available at <http://www.economistas.es/Contenido/refor/Datorefor/ANALISIS%20ACUERDOS%20DE%20REFINANCIACION%20HOMOLOGADOS%20HASTA%20OCTUBRE%20Y%20COMPARATIVA%202015%20Y%202014.pdf>.

⁴³ The assertions in the text stem from a number of interviews with top lawyers from a number of high profile firms in Madrid and with banks and other stakeholders conducted recently in the context of the European Commission's Research Project entitled "*Contractualized distress resolution in the shadow of the law: Effective judicial review and oversight of insolvency and pre-insolvency proceedings*", of which the author is Principal Researcher for the UAM (the project includes also the Università di Firenze and the Humboldt University of Berlin). The results and the data collected will be made available during the first half of 2017.

protect agreements from avoidance; type two are aimed only to restructure the financial debt; and type three is a procedure limited to the smaller businesses. All elements considered, of the three, Type two (homologated refinancing agreements) would constitute the closest to a general out of court procedure to deal with business failure: it can be used before or in a state of insolvency, the content of the agreement is open and flexible, it implies very little court intervention and no necessary insolvency representative involved, and, no less importantly, it is proving a useful tool at least for the medium to upper section of the market. This is the type of agreement that most closely resembles the schemes of arrangement of the UK, and it is the one that could “compete” against the latter when a large debtor and its main creditors seek an strategy to rescue a viable business.

Homologated refinancing agreements can be a stand-alone procedure. This will happen when the debtor and a group of financial creditors conduct negotiations aimed at the restructuring of the business and the financial debt in a private, often confidential manner. Once the agreement has been reached, what initially was a purely-contractual agreement may be protected from ex post avoidance actions and made binding on non-participating/dissenting financial creditors by requesting the confirmation of the agreement before the Court that would be competent to open the insolvency proceedings of the debtor. But most often, this is not how the story goes. Debtors usually try to seek a solution to liquidity tensions on their own (through their own plan, seeking alternative means of financing), and are recurrently reluctant to show their weakness to their financial creditors. Only when it is too late, or when no alternatives have been found, debtors start renegotiating with their standing financial creditors. At that time, down the road, the debtor is likely to be already in a financial situation of liquidity stress, bordering –if not fully in- the terrain of the duty to file for insolvency (art. 5 IL). In this case, debtors initiate or intensify contacts with their financial creditors, but are simultaneously forced to resort to the preparatory “negotiation period” ex art. 5 bis IL in order to avoid breaching the duty to file and stave off the risk of personal liability in case of insolvency⁴⁴. In most cases, thus, homologated refinancing agreements are the subsequent stage of a “negotiation period” where the negotiations have been conducted under the

⁴⁴ The “negotiation period” has a set date of finalization. This paves the way for strategic behavior of the negotiating parties. Most commonly, the interest of the debtor and its creditors will be aligned in trying to avoid formal insolvency proceedings, so it becomes a matter of who stands to lose out more from the failure of the out of court solution. This will depend on many elements: the amount of debt that may not be affected by the agreement, the type of security held by financial institutions, etc. It is not uncommon that the debtor’s main card will be the threat of avoidance of previous transactions with banks, which can only be made valid in formal insolvency proceedings. (...)

umbrella of the law, and the debtor has been shielded from executions and insolvency petitions ⁴⁵.

4.2. Procedure and participating creditors

The petition to homologate a refinancing agreement may be presented by the debtor (which would normally be the case) or by any of the participating creditors. Together with the formal request, the petitioner must submit the complete refinancing agreement, a certification of the auditor that the relevant majorities of votes have been met and the reports that have been issued by independent experts (or indeed any other documentation that is regarded as relevant for the homologation of the agreement).

The petition must be presented in the Court that would be competent to open formal insolvency proceedings. The competence is legally assigned to the Commercial Court of the location where the COMI is (art. 10 IL), although if both the COMI and the domicile are in Spain, but in different locations, the petitioning creditor may choose either of the two places. The Court will register and “admit” the petition (*admission a trámite*), which automatically entails the stay of all executions over the debtor’s property (AD 4 para 6)⁴⁶. The IL expressly states that the decision must be channeled through an “urgent procedure” and be issued within 15 days from the date of the petition. The Judge in charge of the Court will need to be satisfied that all the requirements included in AD 4 are complied with: not only the required majorities, but also the inclusion of

⁴⁵ As a general rule, the decision to commence the negotiation period is sent by the Court to the Registry for its publication in the Registry of Insolvency Decisions, and it is therefore made public, with all the detrimental consequences this may have to the reputation of the debtor. This may be specially problematic in situations –not uncommon– where the debtor has not stopped paying its commercial creditors and has not restructured its size or dismissed employees. The “peace” of the ongoing operations of the business, so important for the value of the business itself (and hence for its creditors) may be jeopardize. In light of this, the Spanish IL allows the debtor to request the confidentiality of the negotiation period, which would, then, not be subject to open publicity. Practice shows, however, by the time the debtor files an art. 5 bis period, much has already been done (renegotiations/delays with suppliers, reduction of staff, etc.) or that some debtors are too big for the confidentiality to be kept, so there is little need for the confidentiality.


⁴⁶ The express mention of the moratorium of executions is necessary, since, even in those cases where the request to homologate an agreement follows a “negotiation period”, this preparatory stage ends precisely with the said request. In any case, and although it is subject to interpretation, the stay of executions triggered by the petition to habilitate the refinancing agreement will not bind public creditors, (who were not bound during the negotiation period and who would not be bound by the homologated agreement).

measures that reasonably ensure the viability of the business activity in the short and mid term ⁴⁷.

4.3. The content of the agreement and majorities required for approval

4.3.1. Creditors concerned in homologated refinancing agreements

This type of agreement is aimed only at the restructuring of the financial debt. By “financial debt” (*pasivo financiero*) the Law understands “[t]he holders of financial claims, independently of whether they are supervised or not”. This is to be interpreted as including all loans and claims where money or another instrument convertible into money was lent to the debtor ⁴⁸, with the exception of creditors that hold “labour claims, claims originated in commercial transactions and claims subject to public law” (4 DA. 1, para 3 IL). This means that it is the activity, not the person that conducts it that matters: if an employee or a supplier lent money outside their own professional or commercial activity, the debt could be part of the refinancing agreement. The law allows employees or commercial creditors to be bound by the agreement if they voluntarily decide to, but their claims would not count for the formation of the majority of the vote ⁴⁹. Naturally, the holders of bonds, obligations or any other type of debt securities are included in the concept. Claims held by SAREB are also included, since they are mainly acquired from financial institutions and were financial

⁴⁷ In order to analyze the compliance with the viability requirement, the Judge will count on all the supporting documents, including -and most importantly- the reports of the independent experts not only on the viability plan, but also on the valuation of the assets (if applicable). The importance of this initial control, however, cannot be underestimated, since this issue cannot be revised later through an appeal against the homologation of the refinancing agreement (see below .

⁴⁸ Naturally, funds and other entities that have acquired ex post financial debt from banks are also included in the scope of the homologated refinancing agreement. It is dubious, though, that all claims become “financial debts” for the mere fact that they have been acquired by a financial institution (bank or non-bank financial institution), for example, through a factoring agreement.

⁴⁹ The AD 4 expressly forbids public creditors from being part of the agreement. They could not bind themselves to it, even if they considered it positive for their own expectations of repayment. This stern rule means, in practice, that public creditors would have to negotiate a parallel, bilateral agreement, that would be subject to the regulation –and the restrictions- of public law. It is also noteworthy that 4 AD does not refer to “tax claims” or generally to the claims of public creditors, but rather to the claims subject to administrative law. This would seem to leave out, for example, claims against the debtor held by a public entity that originates in the latter’s participation in the market. Publicly owned financial institutions aimed at financing certain activities of special value or the SME sector have been bound by refinancing agreements (for example, the Official Institute of Credit of Spain, or its Catalan counterpart).

debts at origin⁵⁰. Further, the law expressly excludes from the counting of the votes those creditors that are considered “specially related” to the debtor. These related creditors may, however, be bound by the agreement⁵¹.

The lack of clarity as to which creditors can be bound by the agreement is a negative characteristic of the system. In some cases, Courts are overly restrictive and endanger the success of the operation. For example, guarantees may have to be left out of the agreement, making the refinancing operation of certain debtors all but useless: think of an industrial company, or a company which exploits concession rights, the financing of which is often designed with guarantees for large amounts. The system would greatly benefit from a more clear determination of the affected creditors; or, perhaps, it would benefit from an enhancement of the kind of affected creditors.

In any case, practice shows that viable debtors conduct negotiations in parallel with those creditors that cannot be subject to a homologated refinancing agreement. A restructuring of the employment contracts or a reduction of the number of employees will be negotiated separately, subject to labour law; or certain key commercial creditors will redesign their relationship with the debtor as the refinancing agreement is being agreed and implemented with financial creditors.

4.3.2. The content of the agreement

The plan must provide a “significant increase of the funds available”⁵² or the rescheduling or writing down of the debts (or a combination of any of the

⁵⁰ The expression SAREB stands for *Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria*. It is Spain’s bad bank, the company that holds the “bad assets” (mainly NPLs of the real estate sector) acquired from troubled financial institutions. The SAREB has been most active in restructuring agreements in Spain in recent years (both in and out of court).

⁵¹ It is not uncommon that specially related parties, such as company directors or entities of the same group bind themselves to the agreement, independently of the nature and the origin of their claim. This is unsurprising, since these creditors are treated as subordinated creditors in case of insolvency (and therefore are bound to receive a worse treatment in the formal in court alternative to the refinancing agreement). The law determines who “specially related” persons are (art. 93): in the case of legal persons, it includes company directors, shareholders with more than 10% of the shares (or 5% if the debtor is listed in the stock exchange), companies of the same group, etc. For more detail on specially related parties and generally on the subordination of claims in Spain, see I. TIRADO, “Ranking and Priority of Creditors. Spain”, in D. Faber/N. Vermunt/J. Kilborn/T. Richter/I. Tirado, *Ranking and Priority of Creditors, ICIL Series*, Oxford University Press, 2016, pg. --- .

⁵² The expression “significant increase” was left open on purpose, to allow the judge to appreciate all the circumstances of the case. There are, however, decisions that have quantified the increase: an early decision of the Court of Appeals of Barcelona of 6 Feb 2009 considered

foregoing), linked with a business viability plans that allows for the continuation of the activity in the short and mid-terms⁵³. Generally, the Law pre-determines the results of the agreement, but not the operations that will lead to the result. As a matter of principle, the debtor and the relevant creditors are free to design the content of the business restructuring measures to be included in the viability plan of the refinancing agreement. The insolvency law includes no express limits, beyond the limit of 10 years in the rescheduling of the debt (like in formal, in court proceedings). This may be achieved by any restructuring measure, of the debt or of the assets of the debtor that the parties consider adequate for the viability of the business. The limits are set by company law, general private or public law (ie, whenever public contracts or concession rights are affected) and by the general tenets of the insolvency law. However, the freedom of content is not so evident when it comes to the effects on financial claims in case they are to be imposed on dissenting creditors. In the relatively scarce practice, some Courts have adopted an open interpretation (ie, no express limits by the law mean no limits by the parties), but some others have made an strict interpretation, according to which only a refinancing of the debt, in the terms expressly regulated in AD 4.2 and 3, are allowed. This latter interpretation would not accept a change in the applicable law or in the debtor (substitution by a newly created ad hoc entity, or a third party acquirer, or another group company). This creates uncertainty and undermines the usefulness of the instrument⁵⁴.

The Insolvency Law conceives homologated refinancing agreements as a possible mechanism of distressed business transfer. In a stern and rather unique manner, the Insolvency Law empowers creditors over shareholders by punishing the latter in case a debt for equity swap fails and the company ends in formal insolvency proceedings. Formal insolvency proceedings ending in liquidation or with the approval of a plan considerably detrimental to creditors will end with the opening of a stage where the debtor or its directors may be held liable or sanctioned (*sección de calificación*). The liability or sanctions will be established whenever the debtor (or its directors) have been found guilty of causing or aggravating the insolvency of the debtor. The Law includes a

that the increase would need to reach at least 20%. The Lead Judge of the Court, Ignacio Sancho, is now at the Supreme Court.

⁵³ The expression short and mid term are also undefined. The interpreter cannot convincingly link the content with the use of short/long term of accounting rules, since the expression “mid term” does not exist in the accounting regulation. Some authors have argued that the minimum period of time of viability of the business should be one year (see, for example, F. AZOFRA, *La homologación*, *op.cit.*, pg. 58). In our opinion, 12 months can be taken as the definition of short term (as accounting rules do), but this would not be enough, since the law (AD 4.1 and 71 bis.1 IL) refers to the viability in the short *and* medium term. The expression is unfortunate because the reference to short term is unnecessary. The minimum time would need to be determined taking all circumstances into consideration, with no pre-defined, minimum time beyond a year.

⁵⁴ In this point, too, the homologated agreements seem less flexible and useful than the schemes of arrangement.

number of situations the occurrence of which will trigger the presumption of culpability. One of these presumptions concerns the behavior of directors and shareholders during the negotiation of a refinancing agreement (of any of the three types). In accordance with article 165.2, the culpability will follow (*iuris tantum*) “(...) when shareholders or directors had rejected, without a justified cause, a capitalization of claims or the issuance of convertible securities, and such rejection had caused the frustration of a refinancing agreement (...)”⁵⁵. In other words, those shareholders that do not agree to the dilution of their ownership rights over the debtor will risk their own personal liability if things go wrong. The law tries to soften the strictness of the rule by stating that culpability will only ensue if the refinancing agreement had expressly recognized a right of preferential acquisition in favour of former shareholders, in case creditors (ie, new shareholders) purport to transfer of the shares in a later moment.

And yet, this “bail-in” rule might seem a bit excessive in the case of homologated refinancing agreement. This type of agreement does not require insolvency; and, even if it did, Spanish insolvency law considers a failure to pass the cash flow test as a situation of insolvency for the purposes of the duty to file. In light of this, a debtor may be solvent, or be undergoing a situation of illiquidity, and shareholders may be forced to relinquish their property to avoid personal liability⁵⁶. This is, actually, a mechanism that very closely resembles the liquidation of the company through the transfer of the going concern, in which the loss is borne by shareholders⁵⁷.

4.3.3. The approval of the agreement

The Law requires different majorities depending on the effects sought and on the content of the agreement. It must be noted that the majorities are based purely on the value of the claims, there being no headcount requirement. There is also no voting by classes within the different financial creditors⁵⁸. The literal reading of the Law would seem to indicate that, in case of groups, the majorities need to be reached only in each of the companies participating in the agreement.

⁵⁵ The article goes on to state that “[T]o these effects, the capitalization of debts will be deemed reasonable when it was deemed so by an independent expert (...)”.

⁵⁶ It is conspicuous that

⁵⁷ A kind of rescue of the business, not of the business owners: see, already for the German law in the early 1990s, M. BALZ, “*Sanierung von Unternehmen oder von Unternehmensträgern?*”, Cologne (RWS) 1986, *passim*.

⁵⁸ The formation of majorities is, thus, different to the rules envisaged for the schemes of arrangement. The Spanish system is much more rigid and makes it difficult to reach a bespoke solution that adapts to the needs of the case. Another element that might push creditors to force a move towards England or Wales.

The AD 4 includes a number of additional rules concerning the participation and the voting of agreements. A first one, conspicuous for its originality, regards syndicated loans (including club loans or generally loans provided by a number of lenders with an agreement that regulates the inter-creditor relationship): independently of the way the loan regulates the formation of majorities or the inner effects of decisions, all creditors will be deemed to have voted in favour of a refinancing agreement when claims representing 75% of the syndicated/club loan have supported it⁵⁹. A second rule –or rather, set of rules- concerns the definition of secured creditor for the sake of the voting. A creditor with a security right will be regarded a secured creditor for 90% of the “reasonable value” of the collateral. The law also provides guidance as to what constitutes “reasonable value”, depending on the type of asset or right that is used as collateral⁶⁰.

The homologation will only achieve an –absolute- protection against avoidance actions when 51% of financial creditors have voted in favour^{61 62}. In order to bind non-participating or dissenting creditors, higher majorities are required. They increase as the content of the agreements gets more detrimental to creditors, as well as with the involvement of secured creditors:

- Creditors without a security right (or secured creditors for the portion of the credit not backed by collateral) will be bound: (i) by an agreement that foresees a rescheduling of the claims for less than 5 years (or their

⁵⁹ There is no doubt that this rule alone applies to the effect of shielding the agreement from avoidance actions, but it is unclear whether additional majorities are necessary to bind dissenting or non-participating creditors: it is arguable that the dissenting creditor part of a syndicated agreement will only be bound in case the majorities included in AD 4. 3 are met.

⁶⁰ In short, the rules are the following (AD 4.2 IL): (i) if the collateral consists of securities listed in an organized market, the average value of the security in the 3 months previous to the opening of the negotiation period (or, if no negotiation period is opened, the *dies a quo* will be the petition to homologate the agreement; (ii) in case of immovable assets, the value will need to be determined by a publicly certified appraiser of immovable property (*sociedad de tasación*); (iii) in case of other assets, the value will be determined by an independent expert. The special valuation mentioned in (ii) or (iii) will generally not be necessary when an independent expert had already conducted a valuation within the 6 months previous to the opening of the negotiation, or when the assets consist of cash, current accounts, electronic money or term deposits of money.

⁶¹ In order to get protection from avoidance actions, the agreement must include the mandatory content (considerable increase of credit, viability in the short-mid term) and, like type I refinancing agreements, the following formal requirements: the certification that the required majority has been reached and the formalization of the agreement and all necessary documents before a public notary (AD 4.1 and 71 bis.1 IL).

⁶² There is no additional requirement that the majority is also reached at a consolidated group level. This is, however, not a clear matter. Authors are divided. The requirement of both majorities has been argued, with powerful reasons, by Prof. F. LEON, in “La reforma de los acuerdos de refinanciación preconcursales”, in A. Rojo/A. Campuzano, *Estudios Jurídicos en Homenaje al Profesor Emilio Beltran*, Valencia (Tirant) 2015, t. II, pg. 1343 et seq., especially at p. 1350. A number of judicial decisions (first instance) have also supported this alternative view.

substitution by subordinated credits with equal maturity), if 60% of financial claims vote in favour; (ii) the required majority will be raised to 75% if (a) the maturities are rolled over for more than five but less than 10 years; (b) a write down of the debt (principal or interests) is included; (c) the claims are capitalized; (d) there is a substitution of the original claims by subordinated debt or convertible securities; or (e) assets or rights are transferred to creditors as payment of their debts⁶³.

- Creditors with a security right will be bound by majorities of 65% or 80% of financial claims when the agreement foresees a content that mirrors (i) or (ii) above, as the case may be.

The binding effect on dissenting or non-participating financial creditors included in the agreement knows no exception⁶⁴. Even if the restructured claims have been previously included as collateral of a securitization, the holders of the bonds/securities do not need to consent to the restructuring. This seems specially relevant in a jurisdiction where holders of mortgage-backed securities have received special protection in case of insolvency proceedings for decades⁶⁵.

4.4. The opposition to the judicial homologation of the agreement

The decision of the Court to confirm the refinancing agreement may be challenged by non-participating or dissenting creditors, affected by the agreement. The opposition must be filed within 15 days from the moment the agreement was made public in the Registry of insolvency decisions or in the official gazette, whatever happens last. The legal grounds to contest the agreement are limited to: (a) the breach of the majorities required by the Law; or

⁶³ The satisfaction of the claims of financial creditors with the transfer of assets or the assignment of rights is a possibility that has its limits. It cannot be used to cover a full liquidation of the business. Such a refinancing agreement would run against the very essence of the out of court solutions as designed in Spain, and would directly contradict the legal requirement that the agreement be based on a viability plan that ensures the continuation of the business at least in the short and mid terms (AD 4.1 and art. 71bis.1). In line with this opinion, see F. AZOFRA, *La Homologación*, op. cit., pg. 69, fn. 37. Cfr. A. CARRASCO, "Impugnabilidad concursal de los acuerdos de refinanciación del RD Ley 4/2014", in *Análisis Gómez-Acebo y Pombo*, March 2014, available at <http://www.gom. ezacebo-pombo.com/media/k2/attachments/impugnabilidad-concursal-de-los-acuerdos-de-refinanciacion-tras-el-rd-ley-4-2014.pdf>.

⁶⁴ This does not mean that dissenting or non-participating creditors need to be included in the agreement. Nothing prevents the debtor and the majority creditors to exclude certain financial creditors from the content of the agreement if they voluntarily so decide (so long as leaving them out does not hamper the viability of the debtor).

⁶⁵ Vid. art. 14 of the Law 2/1981 of 25 March, that regulates the mortgage market (...).

(b) proof that the agreement imposes a “disproportionate sacrifice” to the creditor.

Conspicuously, the objective viability of the plan cannot be subject to appeal. This is clearly a conscious policy decision of the legislator, who deems the viability of the plan sufficiently proved by the endorsement of such high percentages of financial creditors (60-80%, depending on the case). The decision is, on the face of it, arguable. While all rules that add certainty and speed to the process are to be commended, it is undeniable that minority financial creditors –and even non financial creditors, whose chances of repayment will undoubtedly be affected by an agreement that may restructure the business itself, not only the claims- will be unprotected. In this, the Spanish solution also over-protects majority creditors, as was the case with the possible sanctions for non approving a debt for equity swap. A very different approach to the judicial protection conferred upon minority creditors by the “fairness test” in the schemes of arrangement.⁶⁶

The Law does not provide any guidance as to what constitutes a “disproportionate sacrifice”. The expression, however, does provide guidance: the agreement ought to be “proportionate”, and the proportionality must be read in a manner consistent with the finality of the homologated refinancing agreement. In light of this, it would seem reasonable for a creditor to successfully challenge an agreement that includes sacrifices that are not necessary for the short to mid term viability of the business. Dissenting creditors should be bound to assume the minimum sacrifice necessary for the business to be successfully restructured, but not beyond that. More complex is the question if the unjustified sacrifice should not only be gauged in absolute terms but also in relative ones. This could happen in case homogenous financial creditors suffer the consequences of the agreement with different intensity (for example, if they had security over assets with different level of liquidity, or the maturity of the claims of the dissenting creditor was disparate to those voting in favour). In practice, it has also been alleged as disproportionate sacrifice when the inter-creditor hierarchy has not been respected⁶⁷. For example, senior creditors may be made to suffer the same effects on their claims as mezzanine creditors, since the AD 4 makes no treats all financial creditors alike, with he only difference of secured vs unsecured claimants. Finally, authors have claimed that a “best interest” type of test should draw the line of acceptable sacrifice⁶⁸. This cannot be accepted. A first reason is that Spanish Insolvency

⁶⁶ It is not uncommon that, in parallel with the negotiation of the homologated agreement, the debtor conducts a negotiation to restructure its outstanding tax liabilities. The negotiation is purely bilateral, and tax authorities are not reluctant to agree to a rescheduling of the debt (this possibility is expressly contemplated in the Insolvency Law (AD 4 ----).

⁶⁷ [Quote reference](#)

⁶⁸ By “liquidation test” or “best interest test” reference is being made to the rule according to which a creditor may not be paid less in a reorganization plan that she would be paid in

Law does not include a liquidation or best interest test within formal insolvency proceedings, and if the legislator –no doubt, mistakenly- has excluded it in cases of non-secured creditors in formal insolvencies, even less so should it want it in out of court proceedings concerning secured claims. Otherwise, secured creditors fully covered by the value of the collateral could never be forced by an agreement that did not provide for a 100% repayment of their debt. This is so because Spanish Insolvency Law protects secured creditors with absolute priority over the proceeds of the collateral in liquidation proceedings. The application of a rule that does not exist would, then, defeat the purpose of a rule that exists, and that provides no exception for fully secured creditors.

4.5. *International aspects of homologated refinancing agreements*

Given the type of debtors that often use these out of court agreements, the cross border element would seem highly relevant ⁶⁹. Large refinancing operations may be hindered by the uncertainty of the recognition of their effects abroad. A good example could be the doubts cast about the recognition outside the United Kingdom of the effects of schemes of arrangement, fuelled by their lack of inclusion in Annex A of the European Insolvency Regulation 1346/2000 (and the same can be said of the amended version: the European Regulation on Insolvency Proceedings 848/2015 of 20 May -hereinafter “Recast”-) ⁷⁰. The extent to which a refinancing agreement will be recognized in other European countries and beyond will determine its use –and hence its success as a restructuring tool.

4.5.1. **Cross border effects within the scope of the European Regulation on Insolvency Proceedings**

The Recast (art. 1) defines its scope as applying to “(...) *public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganization or liquidation: (a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed; (b) the assets and affairs of a debtor are subject to control or supervision by a court; or (c) a temporary stay*

liquidation. In favour of applying this test to homologated refinancing agreements, see F. AZOFRA, *La Homologación*, *op. cit.*, pp. 109 et seq, and the quotes there included.

⁶⁹ The refinancing agreement of the Abengoa Group included 46 companies, many of which had most or all of its activity abroad. The agreement affects indirectly many other companies of non-Spanish nationality. Vid. ----.

⁷⁰ CITE

of individual enforcement proceedings is granted by a court or by operation of law, in order to allow for negotiations between the debtor and its creditors, provided that the proceedings in which the stay is granted provide for suitable measures to protect the general body of creditors, and, where no agreement is reached, are preliminary to one of the proceedings referred to in point (a) or (b)”.

The general definition is clearly applicable to the “negotiation period” (art. 5 Bis IL), which is a collective proceeding, based on Insolvency Law that grants a temporary stay for a negotiation aimed to find a solution to the debtor’s distress (1.1.c Recast). This definition, however, is more difficult to adapt to the characteristics of the homologated refinancing agreements ⁷¹.

In the latter type of refinancing agreements there is no temporary stay, there is no appointment of an insolvency practitioner, and it would seem difficult to see how the debtor is subject to the control or supervision by the court. The reason is that the procedure is essentially a fully out of court procedure, and that its effects start with the act of homologation itself, by the Court. However, the Spanish Government was able to convince the European Legislator that the homologated agreements are collective insolvency proceedings in the sense of the Regulation. The “negotiation period”, homologated refinancing agreements and out of court agreements on payments are included in Annex A of the Recast. Unless the inclusion of this type of agreements of the Spanish system is challenged at some point ⁷², the topic stays within the boundaries of academic debate.

There are sound arguments to support the interpretation of the European legislator that homologated agreements are collective insolvency proceedings in the sense of the Regulation. The aim of the proceeding is fully in line with the type of out of court procedure that is protected by the Regulation, recommended by the EU Commission ⁷³, and now included in a Directive Proposal ⁷⁴. In fact, also the mechanics of the formation of the agreement are aligned with the typical out of court procedure protected by the Regulation.

No doubt it was due to the development of the reform of Spain’s insolvency system (in different episodes, with uncoordinated patches as problems were identified), and to the problems that the duty to file (art. 5 IL) was creating in

⁷¹ An interesting analysis of the applicability of the Recast (and the EU Regulation 1346/2000) to the new Spanish out of court proceedings can be read here: F. GARCIMARTIN, “Universal Effects of European Pre-Insolvency Proceedings: a Case Study”, in R. Parry/P. Omar, *Re-imagining Rescue*, Insol Europe Technical Series, 2016, pp. 77 et seq.

⁷² Elaborate on how it could be **challenged, if at all**

⁷³ See EC Recommendation on a New Approach to Business Failure and Insolvency, of 12 March 2014, specially paras. 10-14 and 21-26.

⁷⁴ See Section II of the *Proposal of Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures*, 22 Nov 2016, COM (2016) 723. **(...)**

practice, that the legislator conceived the “negotiation period”, which entails a stay of executions against the assets of the debtor (and a ban to file for insolvency), as an independent “procedure” that would work as a preparatory stage to all types of exits (out of court: homologated refinancing agreements, out of court agreement on payments, or even in-court proceedings: anticipated insolvency plan). But the negotiation period is a purely interim, instrumental procedure, that makes no sense as a stand alone solution. Although, in theory, a refinancing agreement can be negotiated out of court without any protection and directly taken to court for its homologation, this is extremely rare in practice. Stand-alone homologated agreements seem almost an academic rarity that would happen only whenever the debtor takes the necessary steps at a very early stage (a stage when a stay of executions is unnecessary). The legislator conceived the negotiation period as an initial stage, and the homologated agreement as its –successful- second stage. It would make no sense to provide full applicability of the Recast to a stage (negotiation) that is purely and merely preparatory, and none to an agreement which is the result the negotiations were aimed at.

The applicability of the Recast implies that the homologated agreements will benefit from all the effects of the Regulation within the EU borders (excluding Denmark). The procedure may be used as main insolvency proceedings or as secondary proceedings, depending on whether the COMI is in Spain or elsewhere (in which case at least an establishment would need to exist).

If the debtor has its COMI in Spain, Spanish law will be generally applicable (art. 7.1 Recast), and, in particular, it will regulate all the elements included in article 7.2 of the Recast (which debtors may use the procedure, effects on the debtor, on contracts, on individual actions, the definition and management of the estate, effects on claims and their hierarchy, or the avoidability of actions and transactions –which are excluded with regard to refinancing agreements by the Spanish law-, only to mention some examples)⁷⁵. This entails that, in principle, the refinancing agreement will trigger the same effects with regard to the debtor and third parties in other EU Member States as in Spain.

⁷⁵ Naturally, all the rules applicable to main insolvency proceedings would apply to the homologated refinancing agreement. This would include the rules concerning synthetic and formal secondary proceedings. The debtor could seek the protection of its assets abroad (with the limitations described in the text) by filing for secondary proceedings wherever it has an establishment. Given the “instantaneous” nature of the Spanish procedure, secondary proceedings would run through the stage of implementation of the agreement. The secondary proceedings abroad could also be triggered by a petition of a creditor or anyone with standing to file in accordance with the law of the Member State of the establishment (art. 37.1 b Recast). The debtor in Spain where a homologated agreement has already been approved and is being implemented could oppose by offering a satisfactory compromise of protection of local creditors (ex art. 36 Recast). The debtor could also suspend the commencement of secondary proceedings alleging the existence of ongoing negotiations (art. 38.3 Recast), but this would not be based on the ongoing refinancing agreement procedure (which, at that stage, by definition has not yet happened), but rather on the existence of an ongoing “negotiation period” regulated under art. 5 Bis of the IL (which, as stated, is also part of Annex A of the Recast).

There are exceptions to this rule deriving from the Recast itself. Special mention deserves the applicability of articles 8 of the Recast. The approval of a refinancing agreement, even with the majorities that make it binding on dissenting secured creditors, will not affect the rights in rem of creditors or third parties concerning assets belonging to the debtor which are situated within the territory of another Member State, “at the time of the opening of proceedings” (and a similar rule applies to assets subject to a retention of title –art. 10 Recast-). If the law of the jurisdiction where the assets are located allows for the foreclosure or enforcement of the security, the creditor will be allowed to notwithstanding any clause to the contrary in the refinancing agreement. The relevant moment to determine the location of the asset will be the decision of the Spanish Court to confirm (homologate) the refinancing agreement, and neither the moment when the homologation was requested or, *a fortiori*, when the negotiation period started (art. 5 bis IL). The reason underlying this interpretation is that, before the decision, there is no proceeding as such, but just an *ex parte* request for the court to confirm a plan. The in-court part of the proceedings is as brief as the issuance of a judicial decision on the merits of the petition. Pursuant to articles 7 and 34 of the Recast, in case secondary proceedings are declared in another Member State, the law of the said State will be applicable, although only with regard to the assets located in the jurisdiction where the secondary procedure is underway. With regard to those assets, thus, the refinancing agreement will not apply in anything that contradicts the local law.

Homologated refinancing agreements may be also used in Spain as secondary proceedings ⁷⁶. The effects of the agreement would be, however limited. Generally, the effects of secondary proceedings are confined to the assets of the debtor located within the territory of the Member State where those proceedings have been opened (art. 34 and 47.2 Recast). Therefore, any write-down or rescheduling of the rights of financial creditors, independently of the nationality or place of operation of the said creditors, will be effective only with regard to the assets located in Spain. Any limitation of the rights of creditors (whatever their nature) over assets situated outside Spain will only be binding on those creditors who voluntarily agreed to it (normally, although not necessarily, in the refinancing agreement) ⁷⁷.

⁷⁶ This is only a possibility under the Recast, since, under the EU Regulation 1346/2000, secondary proceedings could only be liquidation proceedings. The use of homologated refinancing agreements as secondary proceedings does not seem likely to be common. The debtor (or the IP, or both) at the main insolvency procedure would normally achieve the results sought more easily by opening formal –secondary- insolvency proceedings in Spain, in terms of coordination and effects (as stated above, homologated proceedings only affect creditors with financial claims). It cannot, however, be ruled out. Since all refinancing agreements in Spain must be triggered by the debtor, the petition would need to come from the debtor in possession, from the IP, or from both, of the main insolvency proceedings.

⁷⁷ The question of the cross border treatment of the different out of court proceedings is more complex under the currently applicable version of the EU Regulation on insolvency proceedings

4.5.2. Cross border effects outside the scope of the Recast

The situation is more complex concerning the cross border effects of refinancing agreements with regard to countries where the Recast is not applicable. In the absence of bilateral agreements, the recognition of the agreements will be determined by the private international law rules of each jurisdiction, so a case by case analysis would need to be conducted. Many countries have implemented systems that adopt UNCITRAL's Model Law on Cross Border Insolvency Proceedings⁷⁸, literally or some bespoke version of it, so a brief analysis of the efficacy of refinancing agreements against the benchmark of the Model Law could be helpful⁷⁹.

The scope of application of the Model Law is older and more restrictive than the one described above for the Recast⁸⁰. According to the Model Law (art. 2), foreign –insolvency- proceedings “*means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation*”. All requirements are cumulative, and there is no reference to a stage where an agreement is being negotiated.

A first look at the definition would seem to leave out the “negotiation period” of the Spanish law (art. 5 Bis): this preparatory stage is collective, temporary, based on Insolvency Law and aimed at the reorganization of the business, but the assets and affairs of the debtor are not subject to control or supervision of the Court. The notification regulated in article 5 Bis IL creates a stay of executions and suspends the rights of creditors to file for insolvency, but the

(EU Reg 1346/2000), where none of the proceedings are included in the Annex that lists the different national insolvency proceedings. Neither the “negotiation period” (art. 5 Bis IL) nor homologated refinancing agreements would seem to fall under the scope of the general definition of insolvency proceedings. The analysis is similar to the one conducted in the next subsection concerning cross border effects for non-EU jurisdictions, and hence we refer to the arguments there *in totum*.

⁷⁸ By the end of 2016, 41 states of a total of 43 jurisdictions have incorporated the Model Law, in accordance with UNCITRAL's website: http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html.

⁷⁹ An analysis of this kind has already been conducted by F. GARCIMARTIN, in “Universal Effects of European Pre-Insolvency Proceedings”, op., cit., pgs. 86-88.

⁸⁰ This is not surprising. The Model Law will turn 20 years old in 2017, and, already at the time of approval, it mainly incorporated concepts from earlier –failed- European legal texts (on the origin of COMI, with references to UNCITRAL, vid. our previous work “An Evolution of COMI in the European Insolvency Regulation: from *Insolvenzimperialismus* to the Recast”, *Annual Review of Insolvency Law* 2015, pp. 691 et seq.). Concerning its scope, there have been no updates.

debtor may conduct its business in a free manner; in other words, the procedure triggers effects on creditors, but not on the debtor.

The Guide to Enactment and Interpretation of the Model Law states, in this regard: *“The Model Law specifies neither the level of control or supervision required to satisfy this aspect of the definition nor the time at which that control or supervision should arise. Although it is intended that the control or supervision required under subparagraph (a) should be formal in nature, it may be potential rather than actual. As noted in paragraph 71, a proceeding in which the debtor retains some measure of control over its assets, albeit under court supervision, such as a debtor-in-possession would satisfy this requirement. Control or supervision may be exercised not only directly by the court but also by an insolvency representative where, for example, the insolvency representative is subject to control or supervision by the court”*. The explanation might be broad enough to encompass a situation like the one triggered by the Spanish Law, especially if one reads the express reference to the *debtor in possession*. As it is well known, the debtor in possession does not need to be monitored by a trustee (in fact, the appointment of trustees is exceptional) and the control of the committee is voluntary. Although the Spanish negotiation period does not envisage the possibility to resort to the court in order to monitor the activity of the debtor, it can certainly be argued that creditors have standing to petition for the end of the effects (ie, the end of the negotiation period) in case the debtor conducts actions that are extraordinary and hence run counter the negotiation of an agreement. Creditors are negatively affected by the opening of the negotiation period, since they may not enforce their claims or petition for insolvency, and hence they must be protected by the Court. Further, nothing prevents the debtor who notifies the commencement of the negotiation with its creditors (triggering the effects of art. 5 bis IL) to also notify a self-imposed limitation of its management powers and the appointment of a committee of creditors to monitor its effective implementation.

The recognition is easier to justify in case of homologated refinancing agreements. As stated in the previous section, the European legislator has already interpreted the Spanish procedure as one where the debtor is subject to the control or supervision of the Court. And this reading could be supported in the very own texts of UNCITRAL. The Guide to Enactment and Interpretation, in its paragraph 75, states that *“(...) Expedited proceedings of the type referred to in the Legislative Guide (see part two, chap IV, paras. 76-94 and recommendations 160-168) should not be excluded. These are proceedings in which the court exercises control or supervision at a late stage of the insolvency process”*⁸¹. This is exactly what happens in the Spanish procedure. The Court

⁸¹ Furthermore, the Legislative Guide, in its introduction to Recommendations 160-168 (referred to by the Guide to Enactment and Interpretation of the Model Law), describes the proceedings included in the Model Law as *“[i]nsolvency procedures that combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the*

needs to confirm the plan; and creditors may challenge the plan in some cases. There already exist judicial decisions in which a foreign court has recognized a homologated refinancing agreement as a main insolvency procedure⁸².

insolvency law for court confirmation of that plan". The description would seem to fit nicely with Spain's homologated refinancing agreements.

⁸² The decision refers to the relief under Chapter 15 for the mother company and other entities of the Abengoa group in the Bankruptcy Court of Delaware: *In Re Abengoa, SA*, Case - 16-10754. See F. GARCIMARTIN, in "Universal Effects of European Pre-Insolvency Proceedings", op., cit., pg. 88, ft. 14.