International Law Office

October 15 2021

Modifications introduced by preliminary draft bill

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Introduction

On 3 August 2021, the Spanish government submitted for public hearing a preliminary draft bill to reform bankruptcy law and to transpose EU Directive on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt (2019/1023/EU) (EU Directive on restructuring and insolvency) into Spanish law.

It is worth noting that on 1 September 2020, Royal Legislative Decree 1/2020[(1)] came into force, thereby approving the consolidated text of the Insolvency Act.

After the many reforms of the Insolvency Act 22/2003[(2)], the government decided to approve a text to regularise, clarify and harmonise the different reforms of the Insolvency Act in order to achieve a more orderly text. This new consolidated text meant that legal operators went from a regulation contained in the old Insolvency Act of 242 articles into a consolidated text of 752 articles.

One year after the consolidated text of the Insolvency Act entered into force, the government proposed to amend it in order to incorporate the EU Directive on restructuring and insolvency into Spanish law.

Main modifications of preliminary draft bill on insolvency law

Some of the main modifications of the draft are as follows:

- The judicial competence to process some insolvency proceedings has been modified. Currently in Spain, the commercial courts are competent to deal with the insolvency proceedings of companies and individual debtors who are entrepreneurs. However, the courts of first instance have jurisdiction to deal with the insolvency proceedings of individuals who are not entrepreneurs. The new regulation proposes that the commercial courts, which are the specialist courts in this area, should handle all insolvency proceedings regardless of the status of the debtor. At the same time, it is proposed that claims relating to passenger claims against airlines be transferred to the courts of first instance, as the commercial courts are currently collapsing due to the large number of these claims, which have also increased in recent times as a result of the effects of covid-19 on air transport.
- The current regulation of an ordinary procedure and an abbreviated procedure disappears. The draft bill establishes the regulation of an ordinary insolvency procedure and a special procedure for micro-companies applicable to companies with less than 10 full-time employees, less than €2 million in turnover or less than €2 million in liabilities. This new procedure aims to reduce both formalities and time and its processing is basically online. The more important innovation is that the draft bill does not require the intervention of a lawyer or court agent, so the entrepreneur will be able to process the procedure directly with the commercial court through forms that will be provided online and the judge will issue his or her decisions orally. The lack of need for the intervention of a lawyer has been the subject of much criticism by all legal operators who see this new regulation as a possible infringement of the right to a defence. This is because, despite the fact that legal intervention is not compulsory in this type of procedure for SMEs, the new regulation establishes significant sanctions in the event that the debtor does not present the forms correctly, which may even lead to the insolvency proceedings being classified as fraudulent bankruptcy or the refusal to discharge a debt.
- The regulation of pre-insolvency law is modified by introducing restructuring plans, which replace the current refinancing plans. The debtor may propose a plan of how to pay their debt to their creditors and be able to continue with their business in the event of current or imminent insolvency and even in the event of the risk of insolvency, ie, a stage prior to imminent insolvency. The regulation of these restructuring plans includes the figure of the restructuring expert, who will be a professional who analyses the company's situation and aids the debtor in drawing up the debt restructuring plan. The pre-pack administration process, which was already being applied by some of the commercial courts, is incorporated into Spanish regulation. As a result of this new process, the possibility of appointing an expert to prepare the transmission of the production unit, once the insolvency proceedings have been declared, is now incorporated into the Spanish regulation.
- Regarding the insolvency of individuals and the regulation of the fresh start, the new regulation introduces a very significant modification that has led to a large number of criticisms from all professionals in the sector, such as lawyers, economists, insolvency administrators, judges, etc. It eliminates the possibility of a discharge of the public debt in order for a person to obtain the fresh start. This change will mean, in many cases, that it will be impossible for many individuals to have that fresh start, as the new regulation denies the possibility of the fresh start in cases of debt derived from any tax infringement.

This new regulation is not in line with the philosophy and the provisions of the EU Directive that are being transposed, as it provides that member states shall ensure that there is a mechanism for insolvent entrepreneurs to have access at least to a procedure that can lead to a full discharge of debts. Therefore, the new regulation is much more restrictive and demanding than the current regulation, which will mean that the fresh start will be materially inaccessible for the majority of debtors.

As positive points, the new regulation provides for the possibility of obtaining the fresh start without the need to sell the family residence and the assets related to the debtor's professional or business activity, provided that a series of requirements are met.

On the other hand, the need to reach an out-of-court payment agreement prior to the insolvency proceedings as a requirement for accessing the fresh start is eliminated.

Procedure for insolvency without assets

The regulation of the declaration of insolvency without assets is included. The new regulation establishes that an insolvency without assets exists even though the debtor is the owner of assets, as long as they have charges or encumbrances higher than the value of the assets, or that the cost of the sale of the assets is disproportionate, or that the value obtained from the sale is not sufficient to pay the costs of the insolvency proceedings. In these situations, the judge will issue a preliminary order with identification of the liabilities and without further pronouncements. This ruling will be published in the *Official State Gazette* and in the Public *Registry of Insolvency* so that creditors representing at least 5% of the liabilities may, within 15 days, request the appointment of an insolvency administrator to submit a report on:

- whether there are indications of acts prejudicial to the estate that may be voidable;
- if there is sufficient evidence for the exercise of the social action for liability; and
- whether there is sufficient evidence for the insolvency proceedings to be declared fraudulent.

If no creditor applies for the appointment of an insolvency administrator, the individual debtor may apply for discharge of the unsatisfied liabilities.

If the creditors representing 5% of the liabilities request the appointment of an insolvency administrator, the latter will submit a report on the above three points within a period of one month. If there are indications in the administrator's report, the judge will issue a second complementary order in which all the other pronouncements of the declaration of insolvency will be included and the liquidation period will be opened. In this liquidation period, the insolvency administrator will exercise the rescission actions and liability actions within a period of three months. If they do not exercise the actions within this period, the new regulation provides for subsidiary legal standing for the exercise of these actions in favour of the creditors within the following two months in the ways described below:

- regarding the liquidation, the draft bill abolishes the current liquidation plan, which until now has been drawn up by the insolvency administrator, and instead the judge himself will determine the rules of the liquidation process when the liquidation is opened, which may be modified at the request of the insolvency administrator;

- regarding the actions of the insolvency administrator, in addition to maintaining the requirement that they perform their duties with due diligence, as was required until now, the concept of efficiency in their actions is introduced, which is one of the objectives pursued by the EU Directive. The concepts of impartiality and independence in the actions of the insolvency administrator are also introduced; and
- regarding the insolvency administrators, some very important new features have been introduced. In the special procedure for micro-companies, an insolvency administrator will only be appointed if there is no agreement between creditors and debtor for such appointment. In other words, creditors are given a greater role and intervention.

The new regulation establishes excessively severe new rules for the determination of the insolvency administrator's remuneration. It establishes as a general rule that in the event that the common period or the arrangement period exceeds six months, the judge must reduce the remuneration by 50%. Only two exceptions are provided for:

- that the judge, by means of a reasoned decision, considers that there are objective circumstances that justify the delay; and
- that the judge considers that the insolvency administrator has diligently fulfilled their duties.

However, with regard to the liquidation period, the proposed regulation is even harsher. The general rule is that if the liquidation period exceeds six months, the judge must reduce the insolvency administrator's remuneration by at least 50%. This has the following consequences:

- the judge may fix a reduction of more than 50%; and
- the judge may not invoke any exception in order to apply the general rule.

The question is: can there be objective causes that justify a liquidation process of more than six months? The answer is definitely: yes. It should be pointed out that in many cases the delay in the processing of the insolvency proceedings is due to a lack of sufficient human and technical resources in the administration of justice to process the procedures quickly and swiftly, especially in the provincial capital courts where a large number of insolvency proceedings accumulate due to the population density.

Therefore, in most cases, this delay is not attributable to the insolvency administrator, and a reduction of his remuneration is not justified if the delay is attributable to the administration of justice itself.

Comment

In conclusion, the draft bill introduces far-reaching reforms that entail major modifications to the current regulation of insolvency proceedings in Spain. It is important to remember that this is a preliminary draft and that is not yet law, and that there may still be important modifications.

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Endnotes

(1) Dated 5 May 2020.

(2) Dated 9 July 2003.