"Contractualised Distress Resolution in the Shadow of the Law"(*)

NATIONAL FINDINGS FOR SPAIN

I. INTRODUCTION

General consideration

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, 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. The Spanish legislator went on a reforming spree after the financial crisis: from 2009 to 2015, Spain modified its Insolvency Law 8 times, 5 of which including major amendments[1]. While the reforms affected different parts of the Law, the most important ones concerned, directly or indirectly, out-of-court solutions: a period of time to negotiate agreements was created, then expanded and its effects strengthened (art. 5 bis); protection from avoidance actions was introduced for restructuring agreements that met certain requirements (art. 71 bis); 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

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[1] These amendments were made by Royal Decree-Law 3/2009 of 27 March 2009, regarding urgent measures on tax, financial and insolvency matters due to the evolution of the economic situation; Act 38/2011 of 10 October 2011, that amends the Insolvency Act; Royal Decree Law 6/2012 of 9 March 2012, regarding urgent measures on the protection of mortgage debtors with no economic resources; Act 1/2013 of 14 May 2013, regarding measures to strengthen the protection of mortgage debtors, debt restructuring and social rental; Royal Decree Law 14/2013 of 27 September 2013, regarding urgent measures for the adaption of the Spanish law to EU regulation on the supervision and solvency of financial institutions; Royal Decree Law 4/2014 of 7 March 2014, regarding urgent measures on the refinancing and restructuring of business debt; Royal Decree Law 11/2014 of 5 September 2014, regarding urgent insolvency matters; and Royal Decree Law 1/2015 of 27 February 2015, regarding the fresh start mechanism, reduction of financial burden and other social measures.

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accommodates their interests. Instead of one, flexible solution, the Spanish system offers a number of pre-defined paths to restructure viable businesses.

Types of Proceedings

The available proceedings for debt restructuring can be divided in two main categories: on the one hand, court proeedings (*formal*), and, on the other, out-of-court proceedings (*informal or semi-formal*).

The following figures summarize the different options:

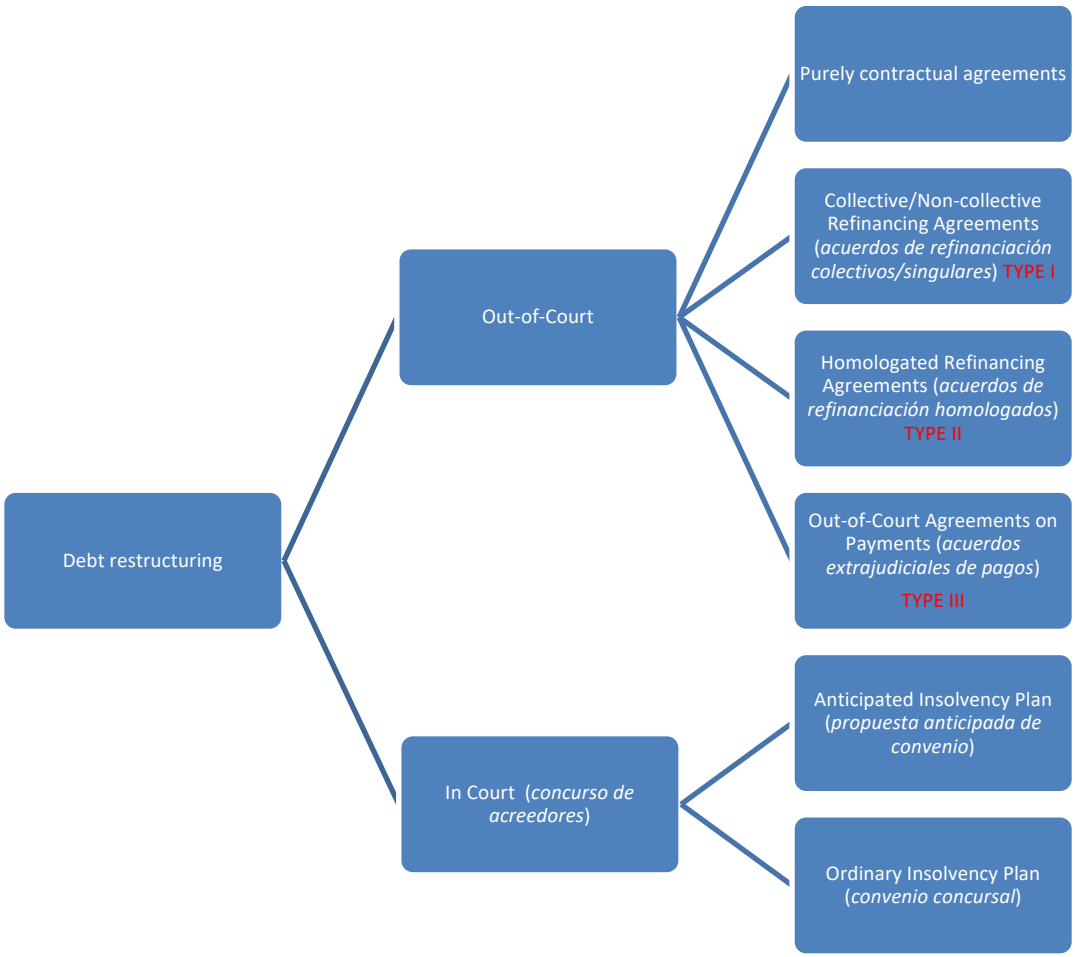

Fig. I: Insolvency proceedings under the Spanish legal framework

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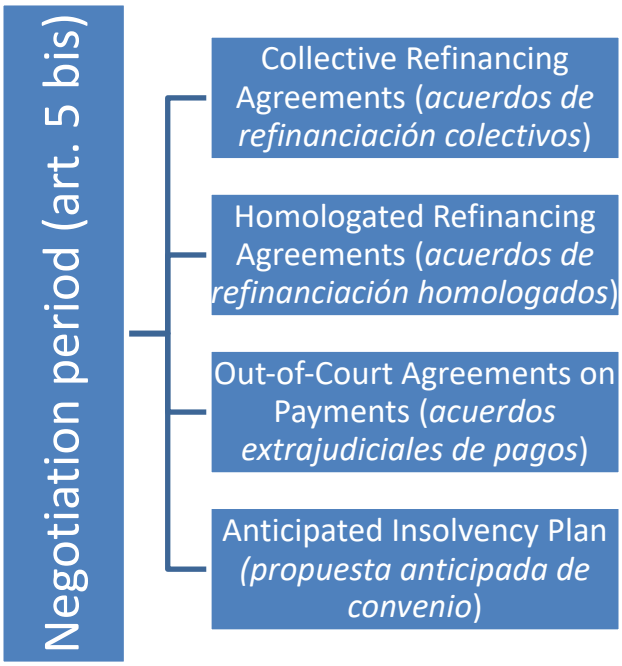

Fig. II: Proceedings supported by the negotiation period

Methodology

The collection of data has been conducted both in a qualitative and in a quantitative way. *Qualitative data* has been collected through a methodology consisting of in-depth interviews (with a duration of approximately 2 hours each). The interviewees were lawyers (both large law firms involved in Spain´s largest restructuring proceedings and medium/small law firms, specialized in SMEs); banks; distressed-debt funds; insolvency practitioners; consultancy firms and judges (first instance Commercial Judges, Judges of the Court of Appeals and Supreme Court Judges). *Quantitative data* has been gathered by analyzing the content of a sample of the Homologated Refinancing Agreements that have been approved in Spain up to December 2017. The sample was formed by more than 70 consolidated agreements. Since the majority of them were group agreements, had we broken them up into the individual agreements affecting every member of the group, the sample of revised agreements would be in the tune of 400, essentially all agreements homologated up to December 2017. The agreements have substantial geographic diversity, although for obvious reasons most agreements are clustered in Madrid, Barcelona and Seville. It should be borne in mind, however, that some of the revised files were incomplete. Indeed, the documentation to which we had access was not homogeneous, and this has led to gaps in the information processed. In fact, in some cases we have had full access to the documents; in others we have only been able to examine the application or the homologation order. The data concerning special out of court agreements for MSMEs has been extracted from the insolvency registry (*Registro de Resoluciones Concursales*), the reports drafted by the public Registrar (*Registradores de la Propiedad y Mercantiles*) and the National Statistical Institute.

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II. THE CONTEXT: AN ANALYSIS AGAINST THE BACKDROP OF FORMAL PROCEEDINGS

In order to understand the legislative creation and design, as well as the use of out of court proceedings in Spain, it is essential to have an understanding of their alternative: formal insolvency proceedings (*concurso de acreedores*). It is the mainly the failure of the latter, that explains and justifies the very existence of the former.

Figure III 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 (i.e., 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 economies[2].

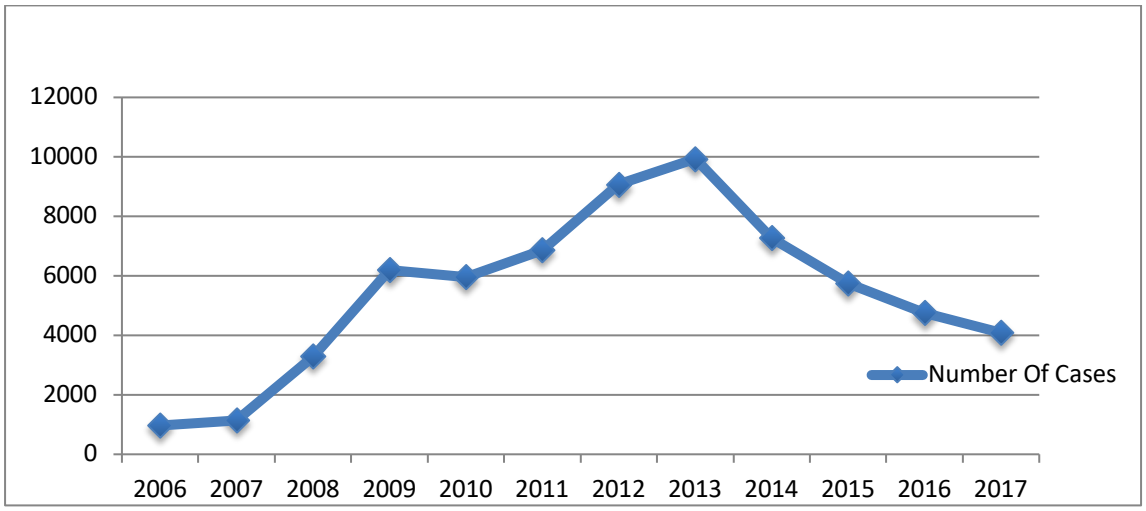

Fig. III: Total number of formal insolvency cases (source: INE)

[2] 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-Statis), all countries that did not undergo a crisis or not as severe as the Spanish crisis.

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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. Indeed, 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 2004 [3]. 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, piece-meal liquidations. The modernization of the legal framework takes time to settle in the realm of insolvency, 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 low.

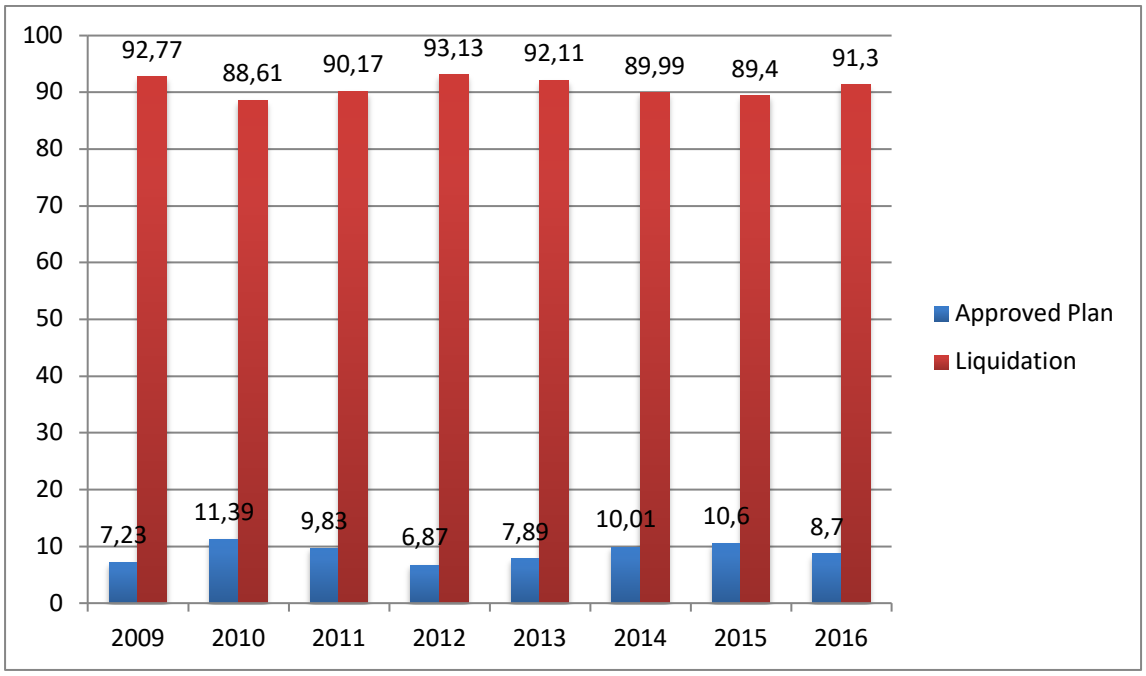

Fig. IV: Exit to formal insolvency proceedings (source: INE)

Figure IV above shows that the vast majority of proceedings end in liquidation. The section in blue (an average of 8,81% 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

[3] 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.

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procedure ending with an insolvency plan increases with the size of the debtor [4]. The percentage of recovery for participating creditors was 50,56% in 2014, 51,68 % in 2015 and 46,2 in 2016 [5]. Unfortunately —and somewhat surprisingly— there exists no data as to the 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 —unexpectedly— 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 2015 [6].

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 shortcomings [7]: (i) there exist breaches of the absolute priority rule, perhaps the most relevant being the ability of the debtor (i.e., shareholders) to block the passing of a plan, even if the company is balance sheet insolvent; (ii) the law includes a convoluted class

[4] 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).

[5] Source of the data: "Anuario 2016", "Anuario 2015" and "Anuario 2014", Registradores, op. cit. 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.

[6] 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.).

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.

[7] 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.

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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 standards 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 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 system [8], 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 created [9]. The problem of the Courts is not the judges that run them, not even the amount of judges available (which has been increased in the past years), but 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

[8] 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.

[9] 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.

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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.

III. OUT OF COURT PROCEEDINGS

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 different out-of-court proceedings. In order to read the data correctly, two elements need to be borne in mind: firstly, there is no quantitative information available concerning purely contractual agreements and refinancing agreements Type I (i.e., agreements that are protected from avoidance actions provided that certain requirements are met), which, according to our interviews, are the most commonly used; secondly, refinancing agreements Type II (judicially homologated) and out-of-court agreements on payments (OCAPs, Type III) have been created recently (only in 2015, in their current design), and therefore the data available only reaches out to a few years and 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).

For the sake of clarity, we have divided them into two groups:

- Purely contractual agreements, and
- Regulated agreements, which include:
    - Ordinary Refinancing Agreements (*Acuerdos de Refinanciación*) [Type I], which can be either collective or non-collective;
    - Homologated Refinancing Agreements (*Acuerdos de Refinanciación Homologados)* [Type II];
    - Out-of-Court Agreements on Payments (*Acuerdos Extrajudiciales de Pagos*) [Type III].

3.1. NON-REGULATED OUT OF COURT RESTRUCTURING 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—

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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 months from the onset of the state of insolvency (i.e., 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 short [10]. 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 risk [11], and creditors (i.e.., financial creditors) were often reluctant to negotiate deals, especially 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 met.

3.2. REGULATED OUT OF COURT RESTRUCTURING AREEMENTS

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. Two of the solutions are open

[10] The two months to file for insolvency (i.e., to negotiate an agreement) would run from the moment the debtor knew, or should have known, that s/he was insolvent.

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

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to any debtor, and one is designed to tackle the financially troubled small and medium enterprises (SME).

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**" (vid., supra, Fig. II). 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 met [12]. 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)[13]. 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 accounts[14]. During the moratorium, no creditor may successfully file for the debtor´s insolvency either.

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 probable [15]. 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

[12] 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.

[13] 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).

[14] Public claims are provided 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.

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.

[15] 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.

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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 Spanish system of out-of-court solution to business financial distress does not include one complete solution: none of the proceedings available can be used by all debtors, bind all creditors or produce all possible results (reorganization, liquidation). Type I collective refinancing agreements simply protect agreements from avoidance; Type II are aimed only to restructure the financial debt; and Type III is a procedure limited to the smaller businesses. All elements considered, of the three, Type II (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.

3.2.1. REGULATED PROCEEDINGS TYPE I: 'ORDINARY' REFINANCING AGREEMENTS (*ACUERDOS DE REFINANCIACIÓN*)

Ordinary refinancing agreements[16] are purely conducted and implemented out of court, with no formal institutional involvement (i.e., no insolvency representative 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.

Ordinary Refinancing Agreements can be either *collective* (art. 71bis.1) or *non-collective* (art. 71bis.2).

With regard to the first category (*collective refinancing agreements*), the Law promotes them 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 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;

[16] Hereinforth, "Refinancing agreements" or "Type I agreements".

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(c) the agreement and all necessary documents have been notarized.

As per the second category (*non-collective refinancing agreements*), they are protected from *ex post* avoidance actions, but may not benefit from the protection during formal negotiations. In order to be protected against avoidance actions, these 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 [17]; (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[18].

As stated above, since those agreements are not subject to any confirmation by the court, and as there is no specific registry for them, ***no quantitative data is available regarding their use***.

3.2.2. REGULATED COLLECTIVE PROCEEDINGS TYPE II: HOMOLOGATED REFINANCING AGREEMENTS (*ACUERDOS DE REFINANCIACIÓN HOMOLOGADOS)*

The Homologated Refinancing Agreements[19] 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-à-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.

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

[18] 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.

[19] Hereinforth, "Homologated refinancing agreements", "Type II Agreements" or "HRA".

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The plan must provide a "significant increase of the funds available" [20] or the rescheduling or writing down of the debts (or a combination of any of the foregoing), linked with a business viability plans that allows for the continuation of the activity in the short and mid-terms. 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 (i.e., 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 (i.e., no express limits by the law mean no limits by the parties), but some others have made a 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 instrument [21].

We have sampled 70 "consolidated" agreements [22]. The majority of agreements are group agreements. We have not broken up the general group agreement into the agreements affecting every member of the corporate group. If we had, the number would be in the tune of 400, essentially all agreements homologated up to March 2018 [23].

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 2016), 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, the procedure is considered ***a much preferred alternative to formal insolvency proceedings.*** Allegedly, HRAs 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: especially those with security rights).

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

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

[22] The analysis only includes refinancing agreements adopted in 2014 and after; the reason is that, previously, the regulation of the agreement differed so largely that a joint analysis would not seem possible. Counting back from 2012, the agreements would be almost 150, and the total number of companies covered over 580.

[23] For example, from 5 June 2012 to 8 April 2017, the Commercial Courts of Barcelona had confirmed (homologated) 38 refinancing agreements, which involved 227 companies.

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Indeed, it is a common feeling among the interviewed lawyers that *formal insolvency proceedings are to be avoided at almost all costs* (although there are certain exceptions when insolvency tools -such as avoidance actions- are truly needed). The reasons that justify the rejection of formal proceedings are many: (i) the need to avoid reputational damage; (ii) the loss of control over the process that formal proceedings do entail; (iii) the lack of predictability that is normally associated to these proceedings; and (iv) the slow pace of the Court system. It should be noted that, while some interviewees have complained about insolvency practitioners, few complaints have been made regarding the technical skills of the Judges.

The regulatory framework appears to be very relevant with regard to refinancing larger companies, in the sense that negotiations are easier when the debts are provisioned and that they are fostered by the re-classification rule.

Different behaviors can be identified during the negotiations, depending on the creditor. While distressed debt funds play a key role in the Spanish market, it appears that banks are more keen on negotiations than funds. Moreover, several differences exist between national and foreign banks, the main one being that the former are more inclined towards refinancing than the latter. Funds often complain about the not-economically rational decisions made by national banks.

Geographically, most agreements have been confirmed by the Commercial Courts of Madrid and Barcelona. Other relevant cities include Seville, Bilbao, Alicante, Málaga, Murcia, Pontevedra or Santander.

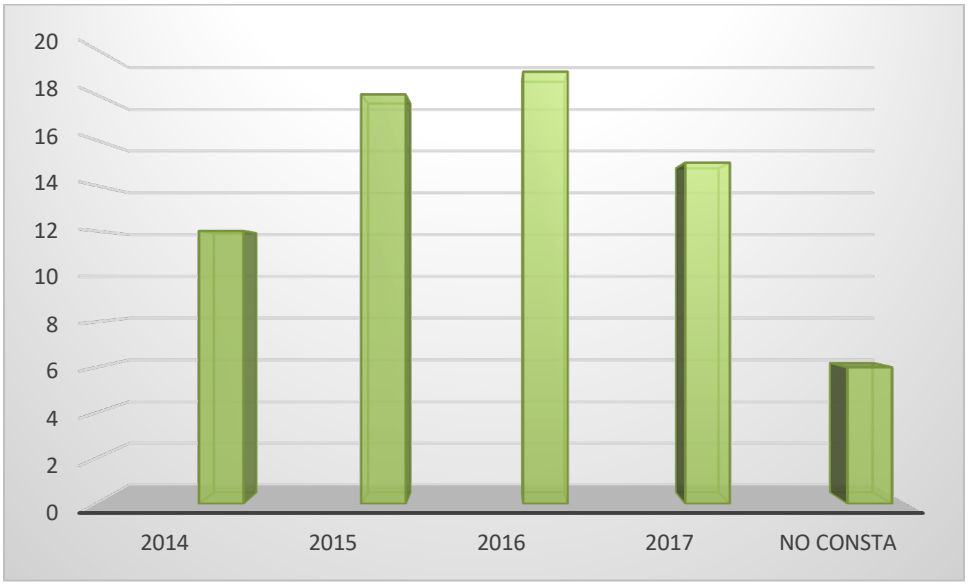

Fig. V: Date of the agreement

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The date refers to the moment when the agreement was entered into (not the confirmation date by the court). It should be borne in mind that the current version of the HRA was implemented in 2015 (hence the agreements reached in 2014 are only partially relevant, and that also explains the short time-range analysed). The most intensive use of the instrument took place immediately following its introduction. In 2015 and 2016 there are a number of highly relevant group agreements. This is an indication that the reform —i.e., the design of the HRA— was, in part, tailor-made to avoid declaring formal insolvency proceedings (*concurso de acreedores*) of a number of large debtors, deemed key to the recovery of the economy. This also explains the behaviour of some creditors, in particular Spanish banks, who were instrumental in approving the HRAs of those highly relevant debtors. In 2017 there is a decrease in the number of HRAs, which has continued in 2018 (according to the provisional data in our hands). The lower use seems to be more linked with the general improvement of the economy (and the return to positive growth rates of the real estate sector), not so much with flaws of the legal design or the institutional setting.

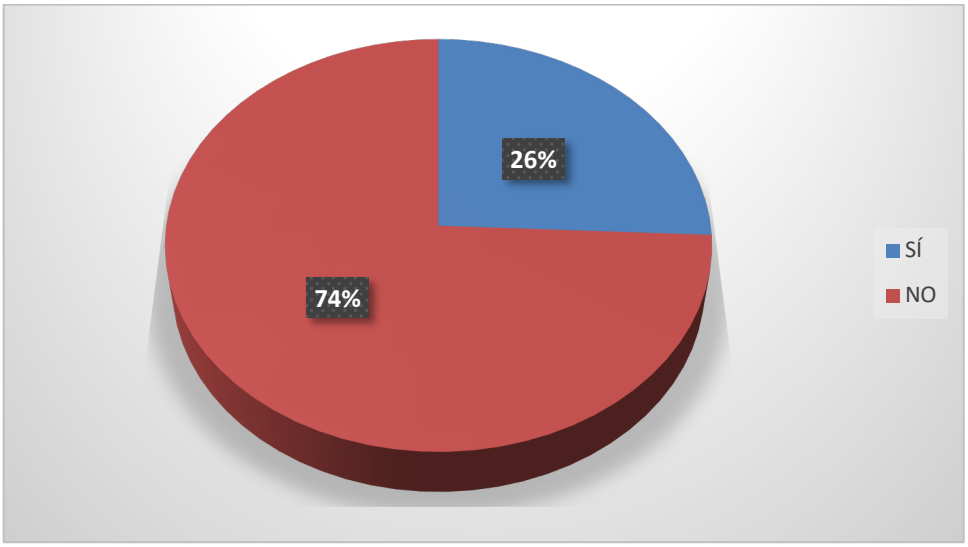

Fig. VI: Consecutive refinancings

The percentage of consecutive refinancing agreements is approx 1 to 3. When it has happened, on average, approx. 2 years have passed between one refinancing and the next one. It must be noted that numbers may, in reality, be higher: we have not been able to capture purely contractual or all Type I and II refinancing agreements that took place before an HRA. Since, by definition, these agreements need no court intervention, obtaining the data has proven extremely difficult.

As to the content of consecutive refinancing agreements, mostly consist of revisions of financial covenants (in order to ease their fulfilment by the debtors) and a revision of the payment conditions (grace periods, new interest rates, etc.).

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Concerning the material content of HRAs,he following are the elements/clauses most frequently included:

- **Early accelleration clauses**: very frequent. The events that trigger the early maturity vary. Mostly: default, cross default, change in legal context, change of control in debtor, cessation of activity.
- **Agreements under condition**: very frequent. Often the condition is Court confirmation. Others: certain majority threholds (< 90%), attaining a cramdown, obtaining authorizations necessary for the execution of the agreement.
- **Independence** between the financial institutions: in terms of liability, the relationship between debtor and banks is bilateral.
- **Rules regulating collective behaviour:** main elements of the agreement require qualified majorityor even unanimity. Forbidden/qualified waivers (the ones that require unanimous/majority consent): events of default, changes in the payment schedule, modifications of the guarantees, etc.
- **Information covenants**: extremely frequent. Obligation to provide information periodic: financial situaiton, plan implementation, etc.
- **Financial covenants**: Very frequent. Net Financial Debt/EBITDA; EBITDA/Financial expenses; Long-term debt/EBITDA; CAPEX, etc. Normally, financial covenants are to be fulfilled until all the debt is repaid. Occasionally, however, the fulfilment of financial covenants is only mandatory during the first years.
- **Business covenants**: Common. Minimum of sales, aggregated yearly production, etc.
- **Affirmative covenants**: cancelling financial instruments, corporate changes (capital increase, substitution of directors, etc.).
- **Negative covenants**: in some cases, negative covenants do not allow any deviation. In others, possible to grant a waiver as (unanimous or by the majority).
  - *Negative pledge*: common interdiction of incurring in more indebtedness, of granting new collateral, etc.
  - *Operational:* Prohibition to undertake corporate changes, entering into non ordinary commercial operations, etc.
- **Shareholders' obligations**: affirmative covenants on shareholders are less frequent (voting for/against certain operation, sale of stock, exercise of political rights, etc.). Non-public shareholders agreements common.
- **Group agreements**: shared liability, subordination of intragroup claims, solvent group members as personal guarantors, etc.
- **Taxes and expenses (consultants, publicising, etc.)**: normally paid for by debtor.
- **Amendment of payment conditions**: considerably frequent measures: conversion of short term credits (factoring, confirming) into mid term facilities; bilateralisation of syndicated loans & conversion in bullet loans:.
- Creation of a **steering committee**: very unusual (2 cases).
- **"Repercussion of the reduction of profitability" clause**: quite frequent (it ensures the investment of the banks, since any change in its profitability will be transferred to the debtor).
- **Sudden breach of mandatory rules**: in some cases, the agreement establishes an exoneration of liability for the banks in case a sudden and unexpected change in the applicable law makes the agreement illegal.

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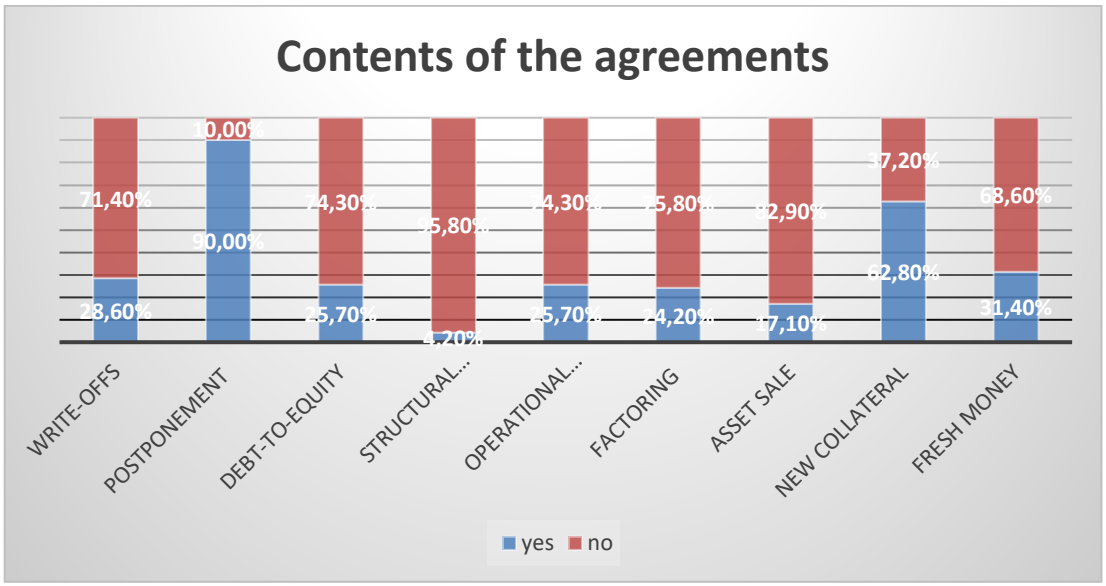

Previous proceedings of corporate restructuring would not seem to be frequent: we have identified 1 merger and 3 operations of capital increase. In other words, company law remedies do not seem to be a useful tool in the times before a company/group starts negotiating a refinancing agreement.

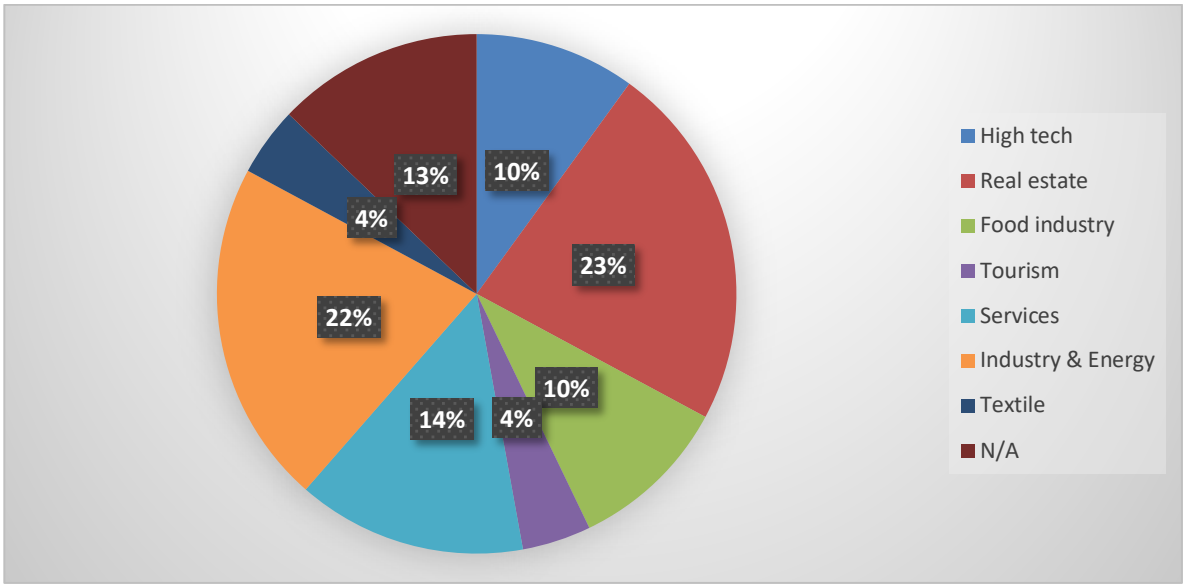

Fig. VII: Sector

Although many of the debtors using HRA are medium to large size debtors, less than 3% of the debtors are listed in the stock exchange or in any other organised secondary market. Real estate

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and industrial/renewable energy companies together add to almost half of all HRAs. If the numbers were broken up into separate companies, the percentage of these two sectors would be signficantly increased since some of the largest group HRAs belong in these sectors.

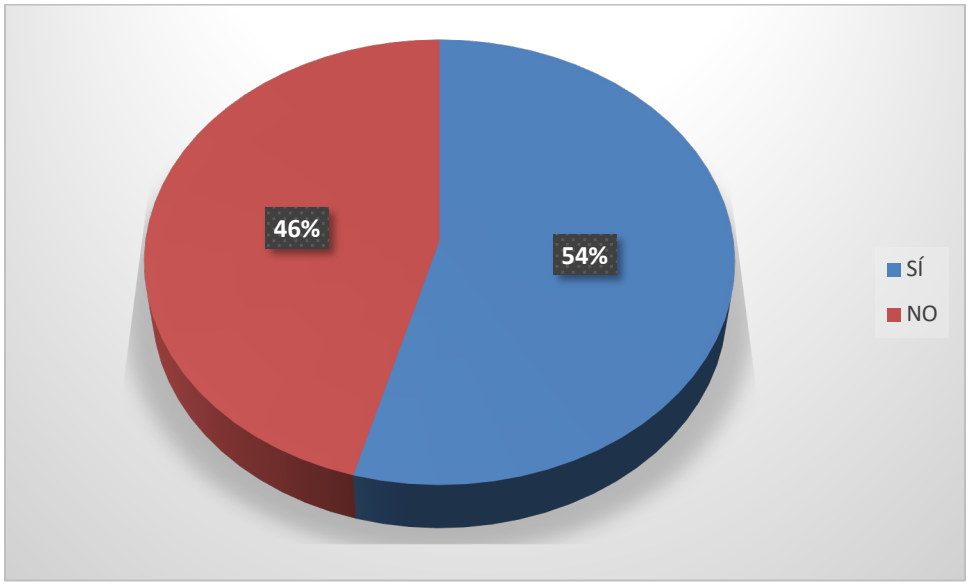

Fig. VIII: Group agreements

The high number of group agreements is noteworthy, since the Spanish Insolvency Act does not explicitly foresee court-confirmed group agreements (not in D.A. 4, only in Art. 71 bis).

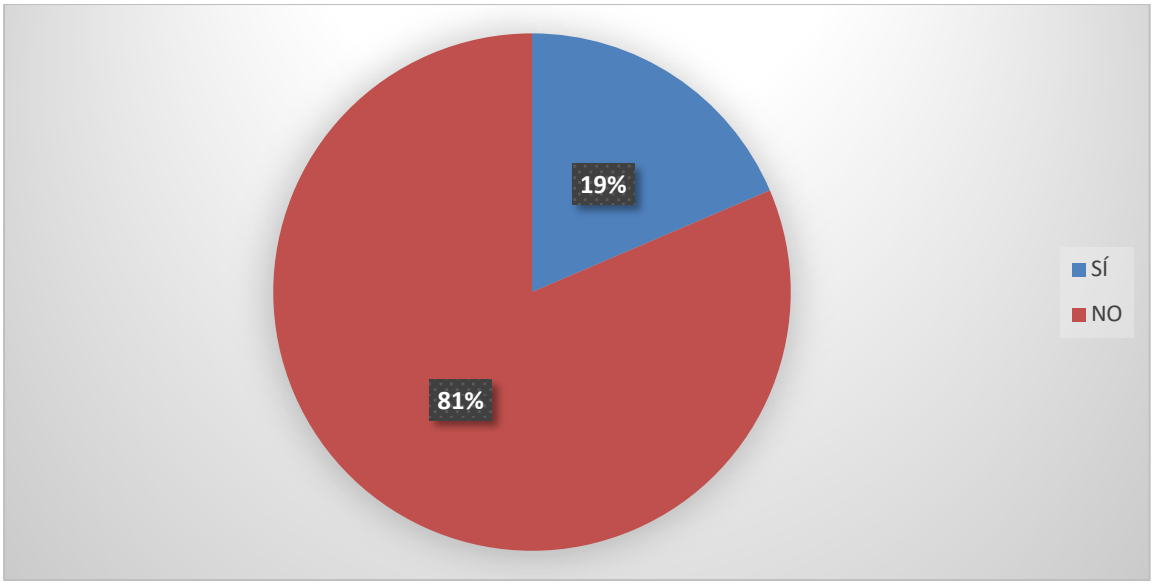

Fig. IX: Communication of the beginning of negotiations

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To our surprise, the petition of art. 5 bis IA (i.e., a stay against executions and the opening of formal insolvency proceedings) in order to negotiate a HRA seems scarcely used. Art. 5 bis is more likely to be used, the smaller the debtor (group of debtors). This may be due to three reasons: (i) on the one hand, because these smaller debtors tend to start negotiating later, when the degree of deterioration of the financial state of the business is higher; (ii) on the other, because they are likely to have a lower likelihood of survival, and hence creditors adopt a more aggressive behaviour towards their restructuring attempts; and (iii) the bigger the debtor, the larger share of adhering creditors (with supporting majorities that may go up to 100%), whose complicity may turn the communication (i.e., the stay it entails) useless.

From the interviews, we gathered that the formal stay is not used in the larger entities/groups because: (i) it may have a reputational cost and endanger the continuation of the business in ordinary conditions (ie, there is no trust in the confidentiality of art. 5bis); (ii) there is little to gain from it in many cases, since negotations will take place at an earlier stage (in part due to stricter covenants in banking contracts, which act as an early action trigger), the negotiation takes place between sophisticated, repeat players that do not stand to gain much from breaking off the restructuring process. However, on the face of it, data on stand-still agreements would seem to lead to a different conclusion:

An *inter-party standstill agreement* (between the debtor and the creditors, without its communication to the court) would seem to take place only in 14% of cases. However, the number is misleading. It only shows stand-stills that have been mentioned in the HRA. Reference is, of course, not compulsory. We think that the conclusion deriving from the interviews is more reliable.

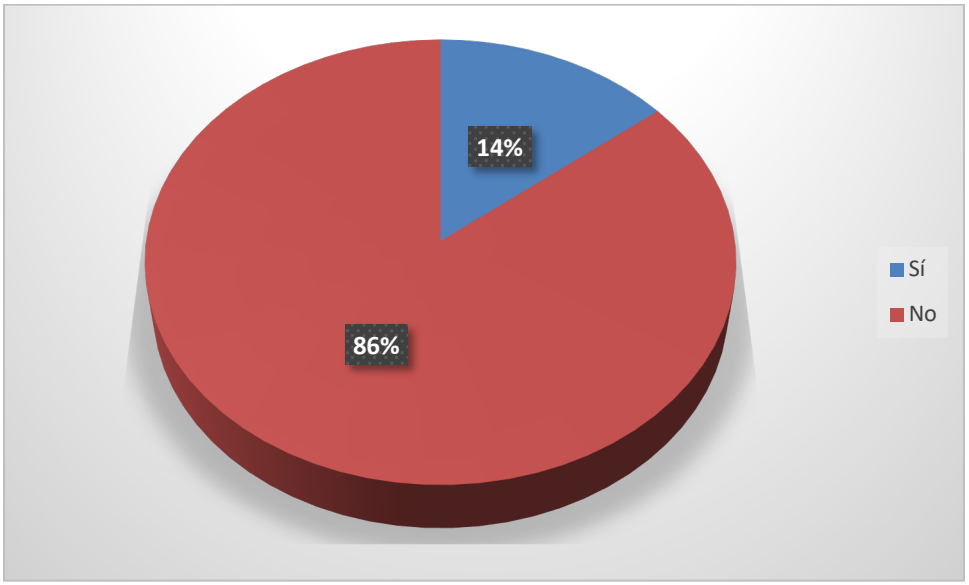

Fig. X: Inter parties standstill agreement

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With regard to the duration of the negotiations and time of confirmation from petition, the data were not available for all the cases. However, as per the analysed HRA and the interviews, it would seem that the *time until an agreement is reached* would approximately go from a minimum of 2 months; to a maximum of 18 months (average 8 months; standard deviation 5 months). With regard to the *time between filing the petition for homologation/confirmation and the confirmation by the court*, the minimum would be 1 week and the maximum would go up to 12 months (average 2,5 months; standard deviation 1,5 months).

Regarding the volume of the refinanced debt[24] by means of an HRA, not a sole agreement refinances less than 1 million euros. This is consistent with the information that was gathered through the interviews, showing that Type II agreements are not used by smaller debtors (even though no explicit limitation exists for its use by SMEs).

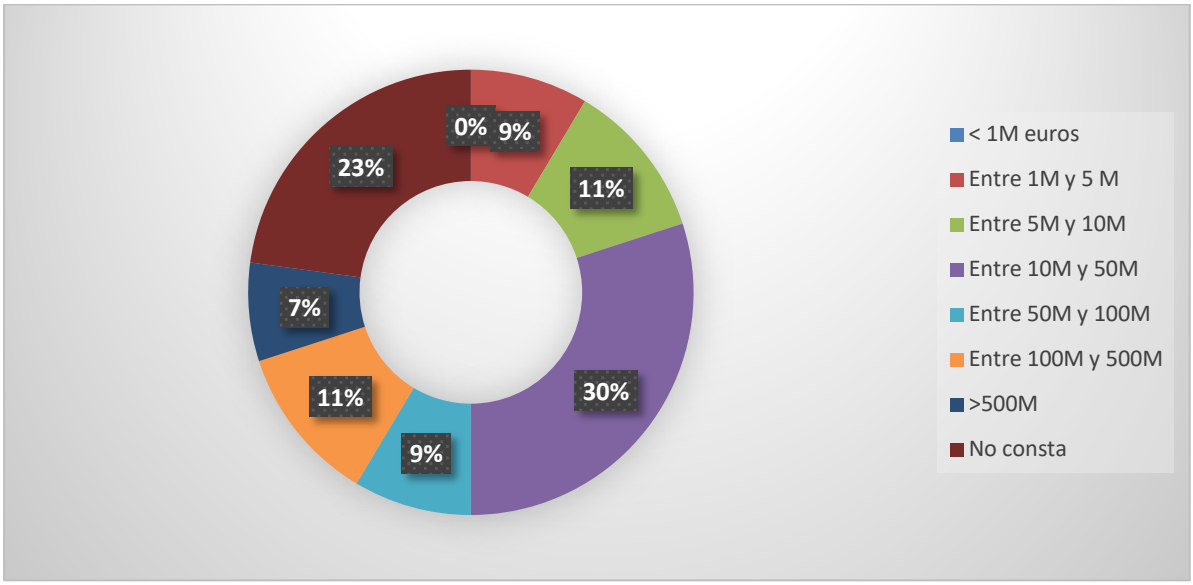

Fig. XI: Volume of the refinanced debt

[24] The figures refer to the refinanced debt, not the total debt nor the total financial debt.

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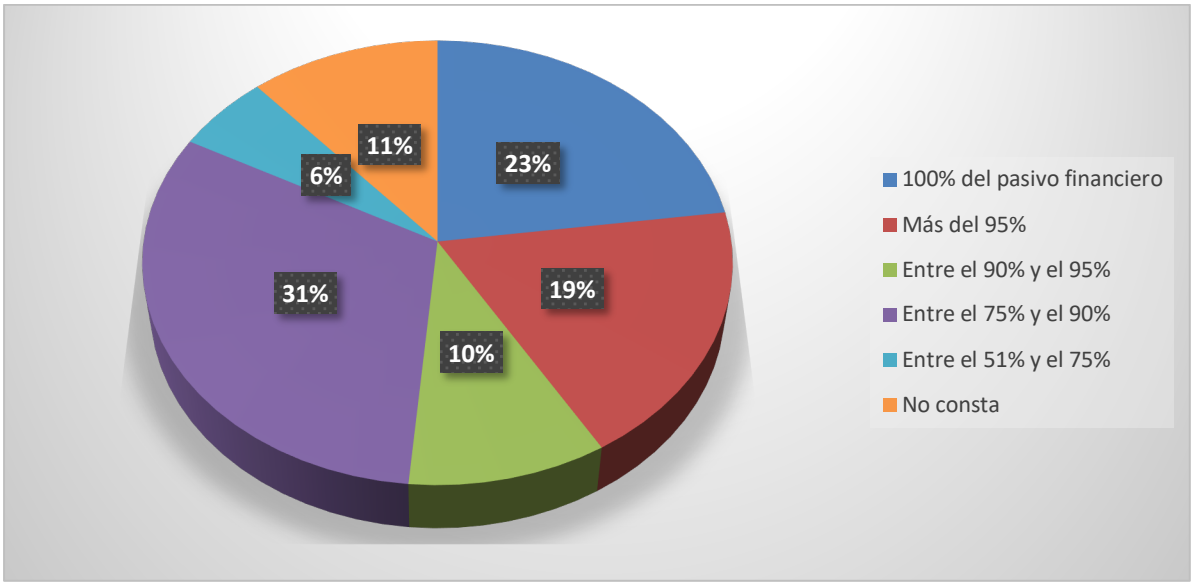

Fig. XII: Majorities obtained (adhering creditors)

A noteworthy fact is that more than half of the HRA are adopted with the consent of more than 90% of financial creditors, and almost 1 in 4 reaches full consensus among them (with a majority that goes up to 100%). Regarding this information, it should be noted that: (i) in group agreements, only the consolidated majority has been taken into account; (ii) the claims held by closely-related parties have not been taken into account (as set forth by DA 4ª); and (iii) there is a special rule for syndicated loans, according to which all lenders are deemed to adhere if at least 75% of them do.

Even though the Insolvency Law expressly states that some of the non-financial creditors may adhere to the homologated agreement (with the exception of public creditors, whose participation is forbidden), this only happened in one case.

With regard to the cramdown on dissenting or non participating creditors, on the face of it, the percentage of cases where the plan has been forced on dissenting creditors can be seen as relatively low, specially considering that the possibility of extending the agreement to holdout creditors is the main advantage of court-confirmed agreements (as compared to Type I refinancing agreements).

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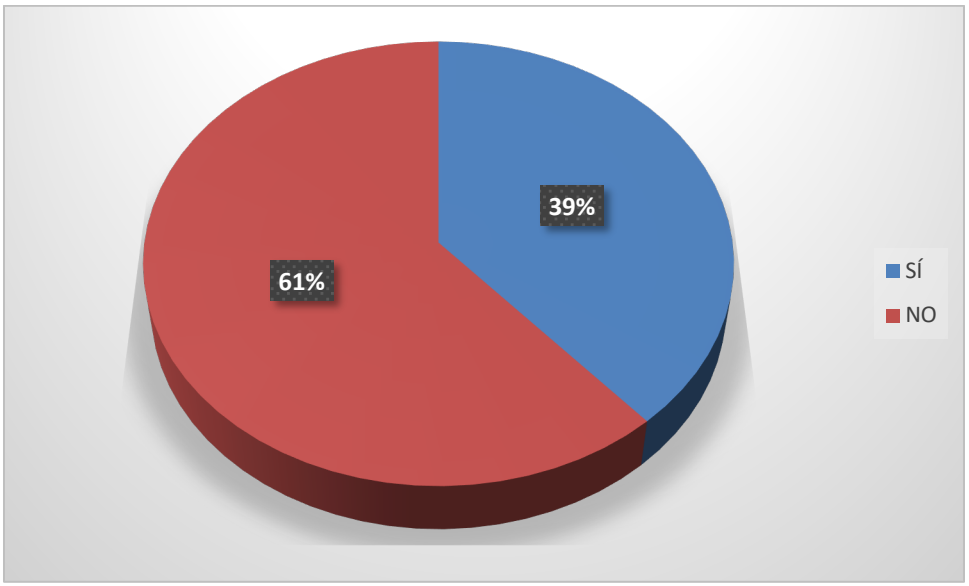

Fig. XIII: Petition for a cramdown

When requested, the cramdown has been granted in 100% of the cases. In some of the reviewed files, however, the cramdown was not granted, but the rejection was due to minor procedural mistakes (v.gr. lack of identification of the dissenting creditors).

In 3 cases, the originally dissenting creditors finally adhered to the agreement during the procedure.

Finally, the confirmation has been challenged by dissenting creditors only in 4 cases(two cases due to disproportionate sacrifice of the creditors and two cases due to the non fulfilment of the conditions requested for confirmation). Out of the two cases alleging disproportionate sacrifice, one has been ruled against the plan (Abengoa). This has put the effectiveness of the agreement on the line. Renegotiations of the payment plan are being conducted with the majority creditors.

3.3 REGULATED COLLECTIVE PROCEEDINGS TYPE III: OUT OF COURT AGREEMENTS ON PAYMENTS (*ACUERDOS EXTRAJUDICIALES DE PAGOS*)

This full out of court procedure is designed for insolvent -or imminently insolvent— MSMEs [25]. 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,

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

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channeled through the Commercial Registry and Chambers of Commerce [26], 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 [27], and the agreement cannot be avoided in a subsequent insolvency.

As stated above, these are proceedings designed to tackle the distress of SME. The access is limited to insolvent or imminently 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 2014, 2015 and 2016 and show the following[28]: (i) there were very few petitions of legal entities (47 cases open in total -12 before the reform, after and until 2016, 17 in 2016), while the petitions for natural persons reached 1748); (ii) the entities were of small size (in 2014, the average value of assets of the debtors was of 377.632 euro, 783.815 euro in 2015 and 321.991 euro in 2016; the average amount of debts in 2016 was in the tune of 231.278 euro, with 92,9% of the debtors owing less than 1 million euro, and 7,1% between 1 and 2,5 million; and with a small volume of business (in 2016 no debtor undergoing this type of

[26] Individual debtors who are not entrepreneurs will trigger the procedure through a Notary Public that may also act as mediator.

[27] 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).

[28] The sources are the "Anuario 2016", "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.

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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, 2015 and 2016 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 (i) a flawed design and (ii) some background factual problems. The design fails specially in two elements: firstly, it leaves out public creditors (i.e., 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 the 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.

Regarding the background issues, and as per the interviews that were conducted with lawyers advising smaller businesses, it would appear that, in the vast majority of cases, the main problem with (M)SMEs is that *debtors seek legal advice too late*. The general opinion regarding the causes for the delay in seeking specialised legal advice is that the problem does not lie in the legal framework (which actually tries to incentivise the adoption of early solutions to the crisis), but in the context and motivation of debtors. Indeed, the interviewed lawyers have identified several causes for this delay. Firstly, there is an insufficient dissemination of these tools amongst the owners and directors of the smaller businesses. Small debtors lack insolvency culture, in the sense that the different mechanisms that the legal system offers remain mostly unfamiliar to them. On this regard, contractualised solutions are particularly unknown. Secondly, formal proceedings (*concurso de acreedores*) are seen as "black holes" that swallow businesses and that should, consequently, be avoided under any circumstances. It should be noted that, in (M)SMEs, the prevailing intention is to safeguard the business and the associated jobs, since normally the employees are members of the same family. Thirdly, two different attitudes are particularly common in small debtors and tend to delay any insolvency-related decision. The first one consists basically of denial of the critical situation that may be affecting the business (the 'ostrich syndrome'). The second attitude that endangers the use of preventive solutions is the belief that, sooner or later, the crisis shall pass. Fourthly, debtors tend to avoid the use of specific tools to remedy insolvency due to the reputational stigma that is usually linked to them. Finally, the late resource to specific solutions usually derives from inadequate advice from the internal/external legal advisors, who lack specific training in insolvency.

As per the above considerations, contractualised mechanisms have proven of little use for smaller debtors, since it is normally too late for their adoption and the design does not allow them to achieve a true debt restructuring.

On another hand, the problems regarding contractualised mechanisms for SMEs are mainly caused by the *lack of collaboration of the two principal groups of creditors*: financial institutions and public creditors. With regard to the negotiations with *financial creditors*, however, the observations that follow were stated by lawyers and rejected by banks. According to lawyers, banks are not

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proactive in refinancing SMEs, and often refuse to negotiate. If negotiations finally manage to start, the immediate reaction of banks is to require collateral or additional guarantees. The rescheduling of the debt is the most common measure, but the practice of ever-greening has also been detected regarding SMEs. The behaviour of banks (that sometimes obstruct a contractualised solution) may be influenced by the regulatory framework (especially the obligation to provision the debts), and also by the slow decision-making process inside them. It transpires form the interviews that, unlike with larger entities, the possibility to "reclassify" a loan after an agreement has been reached (following the 2015 reform) does not foster proactive participation by banks in the restructuring of MSMEs.

Another recurrent complaint regards the *Public Sector*, whose voracity sometimes makes no negotiation possible. Normally, a Public Sector seizure is the event that triggers the fact that SMEs seek specific legal advice in insolvency. In contrast, negotiations with commercial creditors and employees are normally easy, as they bear the insolvency situation with resignation.

As a general conclusion, the legal framework regarding the insolvency of SMEs is technically unsatisfactory but is headed in the right direction. Homologated Refinancing Agreements are not used for this type of businesses. Apart from the flaws in the legal design that were discussed above, OCAPs have turned somewhat useless due to three different facts: they are used too late; the mediators lack the necessary training; and creditors (mainly the most important ones, i.e. the Public Sector and financial institutions) generally show a passive attitude.

IV. SUMMARY OF FINDINGS AND COMMENTS

A) General conclusions

-For medium and large companies and enterprise groups, **out of court solutions are a much preferred solution over formal insolvency proceedings**. According to the unanimous view of stakeholders, formal insolvency proceedings would only be triggered when (i) debtors (ie, shareholders) reject the possibility of entering into a negotiation; (ii) when legal restructuring tools, that only exist in insolvency (avoidance actions, disclaimer of onerous contracts), are deemed necessary to rescue the business; or (iii) when the only solution is a liquidation and shareholders are not willing to collaborate.

It is noteworthy that: concerning (i), creditors have no legal way to force an out of court plan in Spain, and the possibility of making shareholders liable in case they unreasonably reject an agreement with a debt for equity swap seems not to be working; concerning (iii), in Spain a liquidation of the business out of court is not possible, including forcing a sale of the business as a going concern. In this regard, going concern sales are incentivised within formal proceedings my means of enabling rules, such as the automatic transfer of contracts or licenses.

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-The **main reasons for the unanimous preference of out of court proceedings** over in-court proceedings are the following: (i) the loss of control over the restructuring procedure experienced inside formal proceedings; (ii) the lack of predictability in terms of time (procedures tend to last too long, and it is never possible to know when a plan may be passed or implemented) and outcome; and (iii) reputational damage.

The reason (i) is true for all types of enterprises, although with special intensity in case of large entities (which are the ones with the higher likelihood of restructuring as well as those with a higher degree of sophistication, hence with the ability to rescue the business when deemed viable). Medium and small businesses also fear the loss of control, but it is more directly related to the loss of the management, and it is often linked with these businesses as family run businesses. Motive (ii) is perhaps the biggest problem of the system, and it is essentially an institutional issue.

-**The negotiation period (art. 5 bis) is used often and is perceived as a useful tool.** We have not been able to access relevant data concerning the final outcome of negotiation periods, and hence we cannot establish the extent to which it is used merely to procrastinate. Interviews reflect the following: (i) the use of the negotiation period is more frequent the smaller the business; (ii) there is not a strong concern with the negotiation period being abused; (iii) there are only moderate complaints concerning the automatic stay triggered by art. 5 bis; (iv) there is a widespread concern about public creditors not being affected by the stay of art. 5 bis.

Concerning (i), the trend seems to be linked with the delay in reacting to distress and lack of sophistication; regarding (ii), the low perception of abuse and the limited distress caused by the automatic stay seem to be linked with the relative brevity of the period (3 months) and the automatic lifting of the effects when the period ends (ie, it does not depend on action taken by the court, and hence delays are not frequent); concerning (iv), we are arguably before one of the most important shortcomings of the Spanish system: the creation of a procedural privilege for public creditors, which is not mirrored by their situation in the hierarchy of claims within formal proceedings, and which severely undermines the chances of reaching out of court workouts.

-The amendments to the banking regulatory framework bore a very positive effect and fostered refinancing agreements. The possibility to reclassify loans following the conclusion of a refinancing agreement incentive banks´ to restructure and to have a more collaborative behaviour in their management of NPLs.

This rule has now been substituted by a more conservative, bank-centered rule, in line with EBA´s recommendations. The implementation of special rules in times of financial crisis worked in Spain and makes sense generally (see the World Bank´s ICR Principles, p. B5).

B) Specific conclusions on non-regulated and regulated refinancing agreements (except HRA)

-**Purely contractual refinancing agreements** are common in bilateral negotiations between banks and medium to small sized debtors at an early stage, and they tend to have a limited scope (often, simply a rescheduling). On the other side of the spectrum, these agreements also take place in the

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relatively rare cases of very early action by a large corporate group: this will be the case when the distress is still far in time and the agreement needs neither protection from ex post avoidance nor binding a high majority of creditors. The survey shows that bank covenants are useful in the early identification of the situation and the need to act. The larger the business, the more willing to engage in non-aggressive negotiations by banks.

-**Regulated ordinary refinancing agreements**, which are protected from ex post avoidance when 51% or more of the total value of claims support it, **are common in practice**. Since there is no court or IP involvement, we have not any hard data. Our assertion on the high frequency of its use is derived from the interviews, especially those with banks and lawyers of recurrent creditors. The larger the company, the more likely that the refinancing agreement will be taken to court for confirmation (becoming an HRA), since -allegedly- it increases certainty for creditors. This seems thus to be the realm of medium companies, with enough non-public debt to form majorities. Smaller businesses, that tend to have larger portions of public debt, resort more often to purely contractual, bilateral restructurings, mostly in the form of mere debt rescheduling.

-Regulated refinancing agreements that become protected from ex post avoidance without the need to reach a previous majority vote are **not used in Spain**. We have not been able to identify one single case, and interviewed stakeholders have never seen or used one. The institution is not used because its requirements (ie, the specific content of the agreement) are too strict.

C) Specific conclusions on HRAs

-HRA have proven useful to restructure large and very large debtors, and it has been mostly used in the case of corporate groups. Creditors regard this procedure as the best possible solution in the current framework. The main reasons for the largest creditors are:

- (i) creditors can keep control of the solution;
- (ii) there is an easy environment, with repeat players (both concerning creditors and their lawyers) and a high level of sophistication;
- (iii) it is perceived as much less costly and efficient than formal proceedings
- (iv) the legal framework is considered relatively appropriate

-The real rate of success remains to be seen, although it remains quite high until March 2018. For the time being, already a few HRA agreements have been breached and formal insolvency proceedings opened (see esp. the case of Isolux). However, these unsuccessful cases are below 5% of all refinancing agreements. Yet, for most proceedings, it is too early to claim success, since implementation has only started.

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-The main problem of the system is that it is insufficiently regulated. It is unclear ex ante which clauses are going to be enforced and which may be considered as illegal by the judge. This creates legal uncertainty and limits the ability of the parties to reach bespoke restructuring agreements. Numbers, however, do not seem to support this fear. In any case, the following are still undefined parts of the regulation:

- **There is controversy concerning the subjective scope of the HRAs.** In particular, it remains unclear whether contingent liabilities (guarantees, sureties) may take part in the agreement and whether the HRA has effect on them.
- **The cram down rule in syndicated loans is still unclear.** It is argued by some that the rule according to which a vote of 75% of the claims of a syndicated loan is worth 100% of the votes of the syndicate does not mean that a 75% vote crams down the rest of the members of the syndicate.
- **It remains unclear if and to what extent judges must make an analysis on the merits before a homologation takes place.** In particular, it is unclear if the judge must be persuaded that the requirements of art. 71bis IA are met by the agreement (sufficient increase in the credit provided to the debtor to allow for the continuation of the business in the mid term, with a business plan that ensures viability).
- **There is no definition of what constitutes a "disproportionate sacrifice", and hence users complain about the uncertainty this creates on the tenure of the HRAs.** There seems to be consensus that a best interest test should be deemed to apply.
- **The effects of the successful challenge of a homologation are uncertain.** The controversy exists in situations when the success of the appeal is based on the "disproportinate sacrifice" rule. It is unclear if the appeal has only effects on the plaintiff or also on all other equivalent creditors. This poses the problem of the viability of the plan, generally, after part of the creditors have been excluded from it.

-The threat of personal liability on directors/shareholders in case of frustration of an HRA with a debt for equity swap is not pereceived as very influential in the process leading to the agreement. Surprising as it may be, the parties (both debtors and creditors) agree on this.

-Most litigation is started by hedge funds and foreign banks. There are wide complaints about the "parrochial" behaviour of national banks.

-The adequacy of HRAs as a restructuring tool decreases with the size of the business/group. This is in part because smaller businesses, often family owned/run, tend to procrastinate; also because smaller businesses are more often financed through fixed charges and the incentives of financial institutions to assume new risk is lower; another problem is that the creditor structure of smaller debtors changes, and non-financial creditors gain weight (non-financial creditors are excluded from HRAs).

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The design of HRAs is positively valued because it provides the parties with a flexible scenario, where large debtors and sophisticated, repeat creditors have the possibility to control the restructuring procedure. There is no apetite to increase the stakeholders involved, including commercial creditors or enployees. The lack of a proper system of classes is a problem, but the relative small circle of participants and the high techincal level of advisors make up for the said shortcoming. Generally, stakeholders involved in HRAs are happy with an ex post control, and would not want more intense court intervention, especially in an earlier moment. Minority - although also sophisticated creditors: mainly funds- disagree, and consider the system biased agains minority creditors. In our opinion, an adequate system of classes, with a relaive priority rule and a best interest of creditors test would tackle the main problems of the system. A more clear definition of some aspects of the regulation would also add a necessary legal certainty. There are also problems of valuation.

D) Conclusions on special out of court proceedings for MSMEs

-The out of court procedure to deal with financial distress of MSMEs is generally well designed: it is generally inexpensive, templates are provided for participants, a system of mediators is in place, and courts are excluded from intervention.

-This adequate general design could be highly beneficial for Spain´s overburdened court system, currently clogged with cases involving small or very small entities.

-The number of companies that have resorted to this procedure is extremely low. The system is not used. The main reasons identified are the following:

- Public creditors are not involved, and hence small debtors lose interest in using a procedure that cannot bind their main creditor (or one of their main creditors).
- The majorities to reach an agreement are higher than in the case of an insolvency plan within formal insolvency proceedings.
- There is lack of awareness of the procedure and its possible benefits.
- The structure of MSMEs, mostly family businesses, the lack of sophistication of members/owners, who seek advice too late and even identify problems at a very late stage, and the still existing reputational damage prevent debtors from resorting to any procedure. They only file for insolvency when there is no alternative.

Spain needs a comprehensive approach to MSME distress. Creditor passivity could be tackled by the -excessive- rule that subordinates the claims of creditors who, having been duly notified, fail

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to vote in the out of court procedure; but the rule is not applied since debtors do not use the procedure. There are no specific rules fostering adequate creditor behaviour: in the case of financial creditors, their internal structure is often not well suited to identify and rescue viable businesses; and there are no codes of conduct aimed at preventing the destruction of the going concern value by enforcing on viable businesses. Spain is in need of an early detection system; and a proper system of director liability that does not necessarily link liability with the failure to file for formal proceedings. Efforts need to be to made to undertake a policy of awareness and to disseminate the benefits of engaging in early negotiations and channelling solutions through regulated out of court proceedings. Chambers of commerce, associations of entrepreneurs, etc, would be well suited to fill this gap.

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