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AGREEMENTS AND INSOLVENCY PRIVILEGES OF REFINANCING IN THE INSOLVENCY DRAFT ACT

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Regulation regarding the refinancing agreements is inexplicably scattered throughout the Insolvency Draft Act (hereinafter referred to as ID). The chosen nomenclature also contributes to this disarray; and until the Third Transitional Provision it is not said that these agreements are called by the ID "insolvency institutes". We will try to abridge and illustrate the basic problems of the system established by articles 5 bis, 71.6, 72.2, 84.2.11th, 91.6th and 4th AP (additional provision) of the ID. *I will distinguish between simple refinancing, (partially) avoidance-proof financings y financings with provision of cash resources.*

Simple financing

Article 5 bis of the ID maintains the purpose of the former article 5.3 of the Spanish Insolvency Act (LC, as per its initials in Spanish) on the pre-insolvency communications regarding negotiations aimed at avoiding the insolvency proceedings. But the system is improved. The ID confirms the majority case-law, which exempted the judge from assessing the reliability of this communication, the situation of insolvency or the existence of effective and projected negotiations. The sole communication –which the court clerk only puts on record-, postpones in four months the time-limit for applying for insolvency proceedings, except in case the negotiation had led to eliminate the situation of insolvency.

Unlike the current system, negotiations do not have to try to reach an early proposal of composition and the refinancing negotiations also serve, without the insolvency proceedings being a necessary remedy or the fatal consequence of such negotiations. The fact of communicating that the debtor "has opened negotiations to reach a refinancing agreement" is sufficient. Since it is not necessary to evidence the content, the reality or the state of such negotiations, the ID is consistent when requiring no particular requirement to such negotiations. The refinancing agreement can be of any nature and content. Furthermore, it is not even necessary the existence of this negotiation in the initial phase. It can be a debtor's dream of fortune or a simple illusion of being able to convince the creditors. It does not matter, because the communication made by the debtor unconditionally postpones the time limit for applying for the voluntary insolvency proceeding and paralyses within this period the creditors´ requests for necessary insolvency proceedings. And when the debtor finally files and insolvency petition in the new time-limit, if its insolvency continues, it will not have to evidence that there were effective negotiations and that these failed. In other words, the communications known as *communications of article 5.3 of the LC* (of article 5 bis in the ID) are just automatic extensions of the time-limit granted for applying for insolvency proceedings, which are activated by the mere request of the debtor.

From here on, and assuming that a refinancing agreement has been reached, the rules of the ID scatter in an unfortunate way.

Refinancing (partially) avoidance-proof
The refinancing agreement is not mentioned again until article 71.6 ID, as a specific episode of the claim of avoidance in insolvency proceedings. Basically incorporating the same requirements of the current 4th AP of LC (majorities, favourable report from the expert, notarisation), what already justifies a criticism because of having maintained this absurd and burdensome system, we are reminded that the consequence of having met these requirements is a kind of shield against actions of insolvency rescission ("shall not be the subject to rescission"). But there is no such thing and article 72.2 ID keeps empowering the insolvency administration for the lodging of the rescissory and other claims against this kind of agreements. Being this the case, why article 71.6 of the LC keeps stating that such agreements "shall not be the subject to rescission" when this statement is completely denied in article 72.2? Some authors consider that this perplexity could be clarified if we understand that the "rescissory claim" of article 72.2 is the ordinary one of the Spanish Civil Code (CC, as per its initials in Spanish) instead of the insolvency proceedings' claim. As if there was any substantial difference, except for the fact of the refinancing agreements being in danger during four years, instead of two! That being the case, the only shield that can be ascertained is that refinancing agreements that endorse to the requirements and process of article 71.6 ID shall not be subject to the presumption of the insolvency damage set out under article 71.3.2 of the LC, in spite of establishing guarantees on the pre-existing credits. That is not indeed a large advantage, being aware of the current state of the insolvency proceedings' case-law on the meaning of rescissory "damage". Besides, even if this is not the case, the judicial experience on the ordinary rescissory actions of article 1111 CC credits that their prosperity and effects are interchangeable with the specific insolvency rescissory claims. In other words, although the insolvency administration could only terminate these agreements pursuant to article 1111 of the CC, much had not been gained on the field of security for financers. Since insolvency administrators, by definition, shall not be part of the refinancing agreement of article 71.6 LC, these shall not have any incentive (quite the opposite) not to disturb the maintenance of the agreement.

The probability that a refinancing agreement can be affected by an insolvency claim for avoidance of article 71 is not marginal. The refinancing agreement should have been achieved during the "extension" of four months referred to in article 5 bis ID or at a date earlier to the insolvency of the debtor. But, in any case, this shall be a failed refinancing because the insolvency proceedings shall not have been prevented. Otherwise, it would not make sense to protect the agreement against the creditors and insolvency administrators' avoidance powers. A failed refinancing almost by necessity would be a refinancing that, in spite of appearances and experts reports, did not *really* meet the viability criterion of article 71.6. *And therefore a vicious circle would be formed*: article 71.6 wants to partially protect the failed refinancing against the insolvency rescissions; but precisely because of failing, the suspicious of not meeting the standards required by article 71.6 for the refinancing being protected against the rescissory insolvency proceedings' actions would arise.

Hitherto, we know that the *negotiation* of *any* refinancing agreement will suspend during four months the insolvent debtor's duty of applying for insolvency proceedings. And if the agreement is reached, but its intention of avoiding the insolvency proceedings fails, this shall be *somehow* protected against the insolvency avoidance claims, if the agreement meets the requirements of majority, form and content of article 71.6 ID.

Court approved refinancing agreements

Refinancing agreements appear for the third time in the wrong place, the 4th AP of the ID, a

rule that due to its relevance should have been incorporated to the articles of the LC. The 4th AP of the ID is aimed to regulate the *judicial approval* of the refinancing agreements. It is not about a judicial ruling necessary to have a partially protective effect against insolvency proceedings' challenges, to which article 71 of the LC refers, but for the agreement at hand *extending its effects* to the creditors that did not signed it or opposed to it. Let us see, first of all, which are the agreements that can be judicially approved.

For being upheld by the court, a refinancing agreement has to meet the requirements contained in article 71.6 ID. Among others, it has to be adopted by creditors representing, at least, three-fifths of the debtor's total liabilities. *Additionally*, it is necessary that 75% of the financing creditors (not only financial institutions but any financial or credit institution) had signed the agreements. This double quorum has to be reached so that the agreement can be susceptible to acceptance, without being enough one or another percentage. Besides, due to what will be said below, it has to be a refinancing agreement that, at least, involves the setting up of a delay in payments. Under these conditions, the interested party can urge the judge to approve the agreement to equally bind the rest of the financial creditors, the non-participant or the dissidents, except in case of claims protected by a *in rem* security right. An agreement involving a "disproportionate sacrifice" for the financing entities that are going to be affected by the extensions of its effects shall not be approved.

The rest of the regulation contained in the 4th AP is the product of the voluntarism and the lack of meditation. The financing creditors with a *in rem* security are not affected by the approval. Basically, the participants of the banking pool with a collective *in rem* security have nothing to fear, which is precisely the ordinary case where the urgency of an extension of the stay to the reluctant entities is more necessary. Secondly, the only effects that can be extended to the reluctant entities are "the effects of the delay"; new financing charges can neither be imposed to them. But, it is possible that the refinancing at hand only has a moratorium, a new time limit, and that, in return, the refinancers had obtained a review of the credit interests or other financial advantage. How can it be imposed to the reluctant entity to participate in the moratorium without being compensated with the same advantages granted to the subscribers of the agreement in exchange for the temporal surrender of their claims? For example, a new guarantee, where there was none before.

The admission of the request by the court clerk shall mean the stay of the individual enforcement actions for one month. The time limit can be extended to one year, when the judge accepts the agreement. But it is not understood what individual enforcement actions are going to be suspended, since the agreement shall not affect the creditors with a *in rem* security or the non-financial creditors, and this is the case of the Public Treasury, the Social Security or the employment creditors, among others, which are the usual players in individual enforcement proceedings against insolvent debtors. The only individual enforcement proceedings that are going to be affected are those of financial institutions without *in rem* security. Surely, it is about a group of absolutely marginal cases in the everyday reality of insolvency proceedings, if we accept that the creditor with retention of ownership or the financial lessor have a *in rem* security in terms of insolvency proceedings, and that those that have been granted a in rem security without a real value in the insolvency proceedings (such as pledges over the debtor's shares) are also creditors with guarantee for these purposes. For what matters was not whether the guarantee was sufficient to maintain the condition of privileged creditor, but that there is a guarantee. Furthermore, it is not justified the stay of the individual enforcement claims of these finan-

ce creditors when those of the other creditors are opened.

The approved acceptance is published in the BOE (Spanish State Official Gazette) and during the ten days following this date, the financial creditors that had not joined the refinancing plan shall be entitled to challenge the agreement. The only grounds for a challenge will be the lack of percentage of the votes required for a court approval and the production of a disproportionate sacrifice to the challenger. If we consider it at length, there is not a clear closed list limiting the grounds for opposition that can be controlled in the pre-trial admission phase, since any challenge shall deal with the wrong appraisal of credits and debts –affecting the percentages of the required votes-, or the disproportionate burden imposed to the reluctant parties. It is not understood, otherwise, why they cannot also challenge the agreement due to the breach of other requirements of article 71.6, apart from the lack of percentage.

The entities affected by the acceptance shall maintain intact their rights against joint and several co-debtors and guarantors of the debtor. This implies that, inasmuch as the third parties pay, the financial credit shall be substituted by the corporate credit that, to a large extent, will have a subordinate nature. The guarantors being financial entities shall finally subrogate to the position of the credit financial institutions and shall be linked by the same wait refinancing agreement binding these.

Refinancing agreements with provision of cash resources

Hitherto, none of the refinancing agreements we have mentioned required that the refinancing entailed *new cash payments*. If this new money flow takes place, the refinancers that had given it shall be able to benefit from the privilege of claims against the aggregate assets of the insolvency proceedings (post-insolvency or administration costs) up to the 50% of such incomes' amounts (article 84.2.11th of the ID). Please note that these are money contributions in agreements that, by definition, are pre-insolvency agreements. The contributions of economic resources made by partners and people specially related to the debtor, by means of a capital increase or loans or proceedings with the same objective, shall not enjoy this benefit; in other words, a privileged credit against the estate cannot be established through new financial contributions carried out by debtor's insiders. People that due to these inputs had been downgraded as insolvency creditor to the rank of subordinated, keep this condition though being members of the creditors' pool being willing to give money to the insolvency proceedings. Please note that the refinancing agreement *subsequent* to the declaration of insolvency proceedings always generates for the financers a total and privileged credit against the estate, although there are, among the financers, insiders of the debtor!

The amendment of current article 154 of the LC for article 84.3 of the ID limits the importance of some kind of claim being ranked as right against the aggregate state (post-petition claim). The ID endorses the practice of paying the claims against the aggregate assets pursuant to a criterion of reasonable discretion entrusted to the insolvency proceedings' administration ("this shall be able to modify the rule when it deems fit and it is *presumed* that (i) the assets of the estate shall be enough to satisfy all the credits against the aggregate assets"), instead of imperatively imposing the payment of the debts at the maturity date. It is unavoidable that the payment of the financial debt will never be considered as a priority interest of attention when the insolvency proceedings' cash is not enough and there are unpaid working creditors, essential services' providers, lawyers and court agents in insolvency proceedings and insolvency administrators. This reduction also becomes clear when noticing the pay-

ment order of credits against the aggregate assets contained in article 176 bis. 2 ID, if the insolvency proceedings is concluded due to the shortfall of the estate's assets. The factual delay of those credits for new money shall be inevitable when taking into account that 90% of the insolvency proceedings end in liquidation, so that no new resources are generated by the debtor, which rarely keeps the company in business during the course of the insolvency proceedings. If the debtor has not (as will be the case) valuable assets which are not already subject to a special privilege, the refinancing debt shall not be paid, since in the ID the credit for the new money does not prevail against the insolvency claim with a *in rem* security.

Nor should the following consideration be understated. Since the refinancing credit shall not be ordinarily a short-term credit, it can happen that, if the winding-up phase is not opened, the insolvency administration ceases upon the approval of the agreement. A monitoring committee can be planned. But the only objective of this committee would be to ensure the performance of the agreement, not the payment of the credits against the aggregate assets, which may continue or may not be satisfied on the agreement's approval date. Nowhere in the LC or in the ID is it stated that credits arising from the agreement cannot be paid before all the credits against the aggregate assets have been satisfied, since article 157.1 of the LC makes reference to the payment of the credits made during the winding-up phase, not to those made to comply with an agreement of business continuity. And article 154 of the LC is limited to leave opened the enforcement claims for the credits against the aggregate assets when more than one year has elapsed since the filing for insolvency or since the agreement's approval.

The ID does not question whether the creditors providing new cash resources shall be able to agree, instead of the doubtful privilege of having become creditors of the estate, to benefit from an *extension* of the insolvency guarantees, so that the new credit is also covered by them. They may do so if this has been approved in the insolvency agreement to which article 100.5 of the LC makes reference; but I have doubts of this being allowed when it comes to a refinancing agreement outside said agreement. At this point, we cannot go deeper into this, but the doubt poses problems very difficult to solve, such as the questionable maintenance of the priority of these guarantees or the possibility of these being avoided by a rescissory insolvency action, even if these are covering debts of the insolvency proceedings' estate! Please note that article 90.1.6th of the ID stated that *pledges granted for future claims* (what happen if this is about a mortgage or a retention of title?) shall only attribute special privilege to the credits arising before the filing of the insolvency proceedings. But, on the contrary, new article 43.3.1 of the ID shall allow the insolvency administration to carry out acts of disposal (liens) when these are necessary to generate cash or to guarantee the viability of the business, what clearly enables the provision of (new) *in rem* securities for the post-insolvency proceedings' cash credits; provided that the estate has free assets with a realisable economic value.

50% of the refinancing credit consisting of cash payments and which has not already been privileged as administration costs against the aggregate assets shall be considered a credit with general privilege (article 91.6 of the ID). However, the situation of these "privileged" creditors is rather disturbing. If they keep this condition of privileged instead of surrendering it, they will fall outside the scope of the insolvency agreement (article 134 of the LC). Accordingly, these creditors shall not be paid in accordance to the agreement. Furthermore, they shall not be paid through the enforcement concerning special assets, as the creditors with general privileges can do it, at least until an agreement putting an end to the insolvency proceedings' effects has not

been approved. Although article 156 of the LC imposes that creditors with general privilege shall be paid before the ordinary creditors, this priority shall only be attributed if the insolvency proceeding is under winding-up, not when and as long as there is a continuity agreement.