General Information on Debtor's Insolvency Under the Spanish Insolvency Act ("Ley 22/2003, de 9 de julio, Concursal")

Litigation Department

I. Introduction

1. The Spanish Insolvency Act (hereinafter, the **SIA**) establishes two simple and straightforward options designed to bring a solution to the Debtor's insolvency: 1) either enter into a legal transaction with the creditors in which the free will of the parties is evidenced (this is known as composition of creditors or creditor's agreement) or; 2) commence the winding-up of the company.

2. The SIA has been amended several times over the last four years in order to adapt this new model of Insolvency Proceedings to the ongoing financial and general crisis. In particular, both Royal Decree-Law 3/2009, dated 27 March 2009, on urgent measures in tax, financial and insolvency matters and the SIA Amendment Act 38/ 2011, which entered into force on 1 January 2012, have meant substantial changes to the original model.

3. The purpose of this Note is to briefly summarize the main aspects of Insolvency Proceedings under Spanish legislation, focusing exclusively on corporate insolvency. This Note does not enter into technical and complex issues, nor does it deal with exceptional cases.

II. Filing of an application for Insolvency Proceedings under the Provisions of the SIA – Application and Competence

4. It should first be noted that the SIA is applicable to Insolvency Proceedings where the Debtor has its Centre of Main Interests on Spanish territory[1].

5. According to the SIA, the jurisdiction to handle Insolvency Proceedings lies within the Commercial Courts located in the territory where the Debtor has its Centre of Main Interests (Section 10).

   In case the Debtor's registered address in Spain does not match with its Centre of Main Interests, the Commercial Courts of either territory will have jurisdiction and the creditor will decide which one will hear the case.

[1] The Centre of Main Interests of the Debtor is the place where the Debtor usually performs the management of its interests, in a form recognizable by third parties (i.e. publicly). Regarding corporations, their Centre of Main Interests is presumed to be at the place where their registered address is located.

6. The jurisdiction of the Commercial Courts is exclusive. Thus, they will also have jurisdiction on any other incident relative to the insolvency that arises during the course of the proceedings (Section 8 of the SIA).

III. Debtor´s Obligation to File an Application for Insolvency: Alternatives to the Filing for *Insolvency within the Statutory Terms*

7. Under the provisions of Section 5 of the SIA, the Debtor is obliged to file the corresponding application for Insolvency Proceedings within a term of two (2) months after the date in which it knew or should have known about the insolvency situation. Debtors´ lack of compliance with the provisions will significantly increase chances of being held liable.

8. By virtue of the mentioned amendments of the SIA[2], a new possibility for the Debtor was introduced in Section 5.bis, whereby the duty to request a Declaration for Commencement of Insolvency Proceedings is not required for a Debtor who, in a state of present insolvency, initiates negotiations to reach a refinancing agreement aimed at avoiding Insolvency Proceedings or aimed at obtaining adhesions to an early composition of creditors within those Proceedings and, within the statutory term of two (2) months, informs the competent Commercial Court of this situation.

9. It must be noted that no special evidence has to be demonstrated to the Court in order to apply for that extension of the statutory terms.

10. Pursuant to Section 5.bis of the SIA, the Debtor is then entitled to "buy" some time to try to reach agreements with its creditors in order to either avoid the opening of the corresponding Insolvency Proceedings or, if opened, to have an early composition of creditors agreed upon. This alternative provides the Debtor with the right to put on hold its obligation to file for insolvency for a term of three (3) months, extendable to four (4).

    When the three (3) / four (4) month term has elapsed, there are three main possibilities:

    a. The Debtor has been able to reach an agreement with its creditors so that there is no longer an insolvency scenario (i.e., an agreement with 100% of the creditors or that otherwise eliminates the general suspension of payment required). Should this happen, there is no need for the Debtor so as to file the application for Insolvency Proceedings: as to legal terms, there is no remaining insolvency.

    b. The Debtor is able to reach an agreement with more than 50% of the ordinary creditors yet the technical insolvency still remains. In this event, the Debtor will have to file for insolvency but it will have already reached an early composition. In this scenario, Insolvency Proceedings must be conducted, but they will be shortened.

    c. The Debtor is not able to reach an agreement with the required majorities. In this scenario, the Insolvency Proceedings begin and are followed in an ordinary manner. Thus, the Debtor is obliged to file the corresponding application for Insolvency Proceedings within that last month of the abovementioned three (3)/four (4) months term.

IV. Special Reference to the Refinancing Agreements

11. Prior to the recent amendments of the SIA[3], considering the evolution of the economic situation, lenders of the Debtor faced a high risk of rescission when entering into restructuring or refinancing agreements of a company whose financial position showed indications of insolvency.

[2] Royal Decree-Law 3/2009, dated 27 March 2009 and the SIA Amendment Act 38/2011.

[3] Originated first by means of Royal Decree-Law 3/2009 and then by the 38/2011Act.

12. In particular, Section 71 provides certain benefits for all refinancing agreements, which meet the following requirements:

    a. Refinancing Agreements are aimed at either: (i) substantially increasing the funds available to the insolvent; and/or (ii) amending the terms of the debt that is to be re-negotiated by means of the Refinancing Agreement by, for instance, extending the maturity of a credit, etc;

    b. Refinancing Agreements are approved by creditors amounting to at least 3/5 of the liabilities of the Debtor;

    c. Refinancing Agreements are positively informed in a financial expert report, signed off by an independent expert appointed by the Spanish Commercial Registry, who will issue a report assessing: (i) if all the information provided by the parties (in particular, by the insolvent company) is sufficient; (ii) that the Refinancing Agreement is reasonable and the viability plan is sensible and flexible; and (iii) any security guaranteeing the Refinancing Agreement is construed and executed following usual market practice.

    d. Refinancing Agreements are executed before a Spanish Notary Public and incorporated in a public deed with all the relevant documents attached. However, and since notarization is not compulsory, they may be also judicially approved as will be discussed below.

13. The consequences of meeting the aforesaid requirements are:

    a. *Clawback:* Clawback risk of the financing or its security is severally mitigated if the financing is granted within a broader Refinancing Agreement that meets the requirements established in Section 71.6 of the SIA

    b. *Ranking:* As will be discussed at a later point in this Note, the amended Section 84.2.11º of the SIA provides that any credits representing income for the Debtor obtained within a Refinancing Agreement as set out under Section 71.6 shall be deemed 50% credit against the estate or pre-deductible —i.e. super senior as regards the unsecured claims— and 50% privileged —senior to ordinary claims and junior to pre-deductible claims, in both cases as regards the unsecured claims—.

       Obviously this will not apply if the fresh money is obtained from the Debtor itself, its shareholders or from the persons specially related to the Debtor.

14. Although it seldom occurs, the possibility of a Refinancing Agreement entering into force *after* commencement of Insolvency Proceedings cannot be ruled out. Refinancing Agreements, being different from (and logically previous to) a composition of creditors or an early composition of creditors, can also be provided once a company has filed for insolvency. However, after commencement of Insolvency Proceedings, approval by the Insolvency Administrators is required in order for any Refinancing Agreement to be implemented.

    a. Clawback: If the refinancing agreement is granted within Insolvency Proceedings, clawback risks are fundamentally inapplicable.

    b. Ranking: According to Section 84 of the SIA, payments resulting from contracts validly entered into by the Debtor after insolvency will be credits against the estate or pre-deductible —i.e. super senior as regards to the unsecured claims—.

15. Additionally refinancing agreements,, may also benefit from further features if they become judicially approved as set forth in the Additional Section 4th of the SIA. In order to obtain such benefit, all requirements of Section 71.6 of the SIA have to be met as well as a majority of 75% of credits hold by banks or financial entities at the time of approving the said refinancing

agreement. Furthermore, there also has to be an announcement within Spanish State Official Gazette (*"Boletín Oficial del Estado"*). Should there be judicial approval of the aforesaid terms, the main consequence of this judicial approval is, once a first stage of possible challenges is overcome, the extension of effects by means of imposition of the terms contained in the refinancing agreements as to the stay of payment period and not regarding the discharge of credits to the 100% of banks, even those that voted against it, except for those credits holding *in rem* security;.

V. Start of the Proceedings - The Declaration of Insolvency

16. Insolvency will be considered Voluntary if it is the Debtor, who, through his prudence and good will, files an application for insolvency before the competent courts. If, however, the Debtor does not act accordingly, Insolvency Proceedings can be commenced before the Courts by any of its creditors, thus leading to Compulsory Insolvency Proceedings[4].

17. It is not easy for a creditor to give evidence on the Debtor´s insolvency situation so as to apply for Insolvency Proceedings. For this reason, the Debtor's state of insolvency is presumed upon any of the following situations (Section 2.4 of the SIA):

    - General suspension of the current payments of the Debtor's obligations.

    - The existence of pending seizures for enforcements with an overall effect on the Debtor's estate.

    - Unlawful removal or hasty liquidation of his assets by the Debtor.

    - Generalized breach of obligations of any of the following classes: breach of payment of tax obligations during the three months prior to applying for insolvency; the payment of Social Security contributions, and other joint collection items during the same period; breach of the obligation of payment of wages and compensations and other remunerations arising from relevant employment relations during the previous three months.

18. Once the Court receives the application for Insolvency Proceedings, it will examine it and, in the event that the Court deems it complete, it will decide on its admissibility. If, on the contrary, the Court considers that the application is in any way incomplete, it will grant the applicant with a period no longer than five days for its correction (Section 14 of the SIA).

19. The Judge may award the creditors claim for a Declaration of Insolvency against their Debtor with precautionary measures seizing the Debtors´ assets and sometimes their administrators´ assets so the classification of insolvency as an independent plea to establish possible Debtor´s or its director´s liabilities at the end of Insolvency Proceedings is effective.

20. In this regard, the Court is entitled to order the seizure of wealth and rights of the corporation's directors and of those who have held this position. However, inure of such measures will depend on the eventual classification of the insolvency. In case the insolvency is classified as tortuous, then the measures will remain. On the other hand, the measures will be cancelled if the insolvency is not classified as tortuous.

21. In the event that proceedings have been initiated by the Debtor and the Court considers that there is clear evidence of an insolvency situation, the Judge will issue a Court Order declaring commencement of Insolvency Proceedings. If, on the other hand, proceedings are initiated by a

[4] It is important to point out that in any event, we must have a plurality of creditors who hold credit rights towards the Debtor, otherwise, a singular judicial procedure would suffice.

creditor, the Court will admit the petition provided it meets all of the procedural requirements. The Debtor will then be summoned to accept it or to file its opposition within a term of five (5) days.

22. However, the Court will dismiss the petition if the Debtor is under the protection of the abovementioned Section 5.bis of the SIA. This section provides that the Debtor is protected against the opening of Insolvency Proceedings within the term of three (3) months (extendable to one (1) additional month) from the filing of the writ requesting that protection. Thus, only the claims for insolvency filed after that 3-month term (plus 1 additional month if extended) will be accepted by the Court but they will not be examined until the fourth month is completed, and provided that no application for insolvency has been filed by the Debtor itself, which will examined with priority.

23. After the above, within a term of ten (10) days, the parties will be summoned to hold a hearing after which the Court will issue a Court Order either declaring insolvency or refusing it (Section 15 *et seq.* of the SIA). This Order is appealable. Both in the first and second instance, if the claim for insolvency was unfair, damages will be liquidated (apart from legal costs).

24. Insolvency is effective from the date in which the Court Order declaring the insolvency is issued. From this moment on, the proceedings, as well as the notices and formalities, will be made public by different means. In particular, an excerpt of the declaration opening the Insolvency Proceedings will be published with the greatest urgency and free of charge in the Spanish State Official Gazette (*"Boletín Oficial del Estado"*) (Section 21 *et seq.* of the SIA) and, as will be further analyzed, every creditor of the Debtor should be individually contacted by letter by the insolvency administrator, in order to be informed of the proceedings, as well as of the method and deadline to communicate the credits.

VI. Effects of the Voluntary and Compulsory Insolvency Proceedings

25. Insolvency Proceedings affect a broad variety of features:

    i. The intervention or suspension of the Debtor's abilities of administration and management of its assets;

    ii. The integration of all the Debtor's creditors into the aggregate liabilities of Insolvency Proceedings;

    iii. The effects on legal actions and proceedings commenced in other jurisdictions;

    iv. The suspension of any judicial or out-of-Court enforcements against the Debtor may not be initiated and any actions in process will be suspended from the date of the Declaration of Insolvency, and secured creditors will not be entitled to foreclose or forcibly release the guarantee;

    v. The general prohibition of the compensation of the insolvent's credits and debts as well as the suspension of the accrual of legal or contractually agreed interests;

    vi. The Declaration of Insolvency will not affect the validity and performance of contracts with reciprocal obligations pending fulfillment by both parties.

a. Effects on the Debtor: The Insolvency Administrator or Administrators

Consequences on individuals arising out of the Declaration of Insolvency will vary depending on whether the request was filed by the Debtor (Voluntary Insolvency Proceedings) or a creditor (Compulsory Insolvency Proceedings).

1. Voluntary Insolvency Proceedings

26. When the Debtor has taken the initiative and has filed an application for Voluntary Insolvency Proceedings it will retain, as a general rule, the ability to carry out the business management and, therefore, will also maintain the powers of management and disposal of its estate, the exercise of which will only be subject to intervention by the insolvency administrators (Section 40.1 of the SIA).

2. Compulsory Insolvency Proceedings

27. When it is a creditor who has filed a request for commencement of Compulsory Insolvency Proceedings, the exercise of the Debtor's management of its business, as well as the disposal of its assets, will be suspended and substituted by the Insolvency Administrator or Administrators (Section 40.2 of the SIA)[5].

3. The Insolvency Administrators

28. In relation to the above, it is important to point out that once the Insolvency Proceedings have commenced, the Commercial Court will have to appoint one Administrator[6], both in Compulsory and Voluntary Insolvency Proceedings. However, in Compulsory Insolvency Proceedings, as explained above, the exercise of the Debtor's management of its business, as well as the disposal of its assets, will be suspended and substituted by the Insolvency Administrator. Thus, the Insolvency Administrator will take over the functions of the Board of Directors.

29. Furthermore, it also needs to be taken into account that in case of Insolvency Proceedings of Special Relevance, a second Insolvency Administrator will be appointed. Basically, Insolvency Administrators will monitor the Company Directors' management and will have to be consulted for most of the relevant decisions regarding the company's activity during Insolvency Proceedings (i.e. to commence civil actions, to sell relevant assets other than the ordinary sale of goods of services manufactured or provided by the party under Insolvency Proceedings).

30. The appointment of the Administrators is not left up to the parties involved in Insolvency Proceedings. Instead, the Commercial Courts have exclusive authority to appoint the Administrator or Administrators.

31. As a general rule, the Administrator is selected by the Court amongst those individuals who have expressed their availability to perform the duty of Administrator on the relevant professional association (as set out in Section 27 of the SIA), in particular:

- A lawyer with at least five (5) years of effective professional experience and a Master's Degree in this particular area; or

- An auditor, economist or mercantile graduate with at least five (5) years of effective professional experience and also specialized in this professional field.

[5] Notwithstanding the above, it must be noted that the Court has the authority to establish suspension in the event of Voluntary Insolvency Proceedings or may ordain the intervention within Compulsory Insolvency Proceedings. The grounds for choosing between any of them depend on imminent risks and/or on any advantages for the proceedings there may be.

[6] This is a remarkable novelty in the amended SIA. Previously, the rule was to appoint three Insolvency Administrators even though in the cases of abbreviated proceedings there was just one (1) Insolvency Administrator.

Candidates should be selected from lists of professionals submitted by the relevant professional associations to the Courts on a yearly basis.

However, special rules are established to meet the special requirements of Insolvency Proceedings of (i) entities that issue negotiable instruments traded in the stock market and; (ii) financial or insurance entities, taking into account that in both cases these entities are under the supervision of the Public Agencies. In such cases, the respective Public Agency proposes candidates and the Judge accepts one of them.

Finally, Section 28 of the SIA sets forth a series of limitations to the appointment of the Insolvency Administration.

32. After the appointment, Insolvency Administrators must perform their duties with due diligence and the obligation to act as loyal representatives of the insolvent company.

Section 36 SIA provides for joint liability of Insolvency Administrators and Delegate Assistants towards the Insolvent and the Creditors for damages and losses caused to the estate by acts or omissions which are unlawful or conducted without the necessary due diligence. Nonetheless, Delegate Assistants may be exempted from such liability provided that they acted with sufficient due diligence to prevent or avoid the detriment.

These actions, carried out in the interest of the estate, must be substantiated before the Court handling Insolvency Proceedings. Moreover, such actions expire after four years (i) from the claimant having knowledge of the damage or loss the claim concerns and; (ii) in all cases commencing when Insolvency Administrators or Delegate Assistants have ceased to hold office.

If the Ruling rendered contains an order awarding compensation for losses and damages, the creditor exercising the action, in the interest of the estate, will be entitled to reimbursement of the necessary expenses borne against the sum received.

Furthermore, and irrespective of bringing "actions in the interest of the estate", creditors or third parties are also entitled to bring liability actions for acts or omissions of the Debtor that damage them directly, known under Spanish legislation as "individual actions".

33. In addition, it must be noted that:

- Both the Debtor and Insolvency Administrators have very limited powers to sell assets during the Insolvency Proceedings, especially during the Common Phase, thus generally requiring the Court's approval within the special procedural plea set forth in Section 43 SIA.

- In general terms, the powers and authorities of the Insolvency Administrators will be tailored and supervised by the Court. Thus, the more relevant decisions are to be validated by the Court and/or can be challenged before the Court.

34. Finally, it must be pointed out that the Insolvency Administrators also draft three reports that highly influence the course of the Insolvency Proceedings:

- Firstly, the *Insolvency Administrators' Interim Report,* which must be submitted to the Court within the first two months (extendable) of assuming this position. In that report, the Insolvency Administrators will provide the creditors with a general financial view of the Debtor through both its assets and liabilities. The liabilities are listed in the *Interim Creditors List* with the credits that have been communicated

and then approved by the Insolvency Administrators, along with any other credits that they must include because they result from the Debtor´s accounting records. The assets are reported in the *Interim Inventory*. Both the *Interim Creditors List* and the *Interim Inventory* are subject to challenges by, respectively, a creditor that is not included or not correctly listed (the amount or the classification of its credit is not correct), or a third party that alleges that an asset of its property is incorrectly recorded in that inventory as owned by the Debtor.

- Once all those claims of challenges are decided, the *Insolvency Administrators´ Definitive Report* will be submitted to the Court, updating the Credits List and the Inventory, providing a general overview of the Debtor´s situation and frequently announcing rescission claims and other relevant civil or criminal actions to be initiated by the Insolvency Administrators. The judicial approval of that Definitive Report means the end of the so-called Common Phase of the Insolvency Proceedings, thus giving rise to the opening of the next phase, to settle the Insolvency Proceedings (by means of a composition of creditors or a winding-up phase to liquidate its assets, see below section VII).

- Finally, the Insolvency Administrators also draft the *Guiltiness Report* at the beginning of the special procedural plea to classify the Insolvency as fortuitous or tortious. This report, together with a similar report issued by the Public Prosecutor, establishes the framework of the discussion about that classification. Thus, in the event that both reports recommend a classification as Fortuitous, there are no chances to change that classification. , On the contrary, in case both of them propose a classification as Tortious, the defendants will have to allege against such decision (see below Section VIII).

b. Effects on contracts

35. The Declaration of Insolvency should, in principle, not affect the validity and performance of contracts with reciprocal obligations that are pending fulfillment by both parties. This principle has various legal consequences:

36. Firstly, the SIA provides a very important prohibition —commonly established on foreign jurisdictions— preventing the parties from reaching an agreement setting forth the termination of a contract due to the event of insolvency of either party. This agreement will be considered, as a general rule, null and void in contractual terms. Notwithstanding, Section 63 SIA refers to special legal rules still in force after the SIA was enacted: (i) legal abilities of early termination in some special agreements (i.e. contract of mandate) and (ii) legal provisions granting the validity of performing an early termination agreements in connection with an event of default provided by a given insolvency clause. That is the case of financial collateral arrangements regulated under Royal Decree Law 5/2005.

37. Secondly, even if the declaration opening the Insolvency Proceedings does not in itself affect the validity of contracts with reciprocal obligations pending fulfillment, both by the insolvent Debtor or the other party, it does not mean that the declaration eliminates the power to terminate contracts alleging a breach of contract neither with grounds on the general provision in Section 1.124 of the Spanish Civil Code nor grounded on a clause of early termination agreed between the parties (provided that the early termination is not only founded on the insolvency but on a real breach of contract).

    However, early termination on grounds of breach of contract within Insolvency Proceedings has important special rules:

    - Single performance contracts can only be terminated for breach of contract that has taken place after the Declaration of Insolvency Proceedings.

- After the Declaration of Insolvency Proceedings, the termination action is brought before the Insolvency Court and will be substantiated as an insolvency procedural plea (thus, a single out-of-court formal notification by the *in bonis* party based upon a particular agreement or based on Section 1,124 of the Spanish Civil Code will not suffice).

- The Debtor may defend against the remedies on grounds of breach of contract by relying on the general defenses and finally a special one: the allegation of "the interest of the estate". In other words, the relevance of the contract for the survival of the insolvent company and the payment of the creditors. However, courts very rarely dismiss claims for the termination of contracts with grounds based on this exceptional ability of the court. If the court, considering the interests of the Insolvency Proceedings, resolves to fulfill the contract, the services already due or to be performed by the insolvent debtor will be paid immediately from the estate.

- Once the termination of the contract is resolved, all the obligations pending maturity will be extinguished. With regard to those that have already matured, if the breach by the insolvent debtor was prior to the declaration of Insolvency Proceedings, and the creditor has fulfilled its contractual obligations, Insolvency Proceedings will include its credit among the Creditors List. If the breach were posterior to the Declaration of Insolvency, the complying party's credit would be considered a credit against the estate and it would therefore receive preferential treatment. In all cases, the credit must include the appropriate compensation for damages and losses. Thus, the time in which the contract was not honoured has relevant consequences both in limiting the possibility of an early termination (single performance contracts can only be terminated for breaches of contract that have taken place after the Declaration of Insolvency) and in the classification of the credits of the non-insolvent party to the contract.

- The Insolvency Administrator, through its own initiative or by request of the Debtor, may (i) reinstate the loan contracts and other financial agreements early terminated by the party *in bonis* due to failure to pay the principal or the interest accrued, provided that the breach of contract has taken place within the three (3) months preceding the Declaration of Insolvency; and (ii) reinstate the contracts to acquire moveable or immoveable goods for a consideration or via payment in installments whose rescission has occurred in the three (3) months preceding the Declaration of Insolvency.

38. Finally, the Debtor or the Insolvency Administrator, the first one in the case of voluntary proceedings and the second one in the case of compulsory proceedings, are vested with the authority to request the setting aside of a a contract (rescission) if they deemed it convenient to the interests of the estate (the general interest of the creditors within the Insolvency Proceedings). The Court will then hold a first hearing just to mediate between the parties so as to reach a settlement about the termination of the contract and its economical consequences. In the event the parties do not reach an agreement, it is up to the competent court to agree to the rescission (if the court finds that the early termination is indeed in favour of the general interest of the creditors) and to establish the consequences: awarding the *in bonis* party forced to prematurely terminate the contract not only with the restitution for all of its property but also with compensation for damages, to be drawn from the estate.

39. Finally, it is useful to recapitulate the special rules regarding contracts of continual performance which the SIA contains:

    i. The *in bonis* party who has complied with its obligations may terminate a contract with the insolvent Debtor by alleging breach of contract, even if that breach was previous to the Declaration of Insolvency.

ii. According to most of the judicial precedents and authors, credits born from a contractual breach that took place before the Declaration of Insolvency will be included in the Creditors List, and those credits born from later contractual breach will be drawn from the estate.

c. Effects on Credits and Interests

1. Integration of all credits. Creditor´s burden of communication. Exception

40. Once the Insolvency Proceedings are opened, all the Debtor's creditors, whether ordinary or not, regardless of their nationality and domicile, are legally integrated into the aggregate liabilities of the Insolvency Proceedings, with no exceptions other than those set forth by the SIA.

41. It can be said in general terms that creditors have the burden to communicate their credits to the Insolvency Administrator at the very beginning of the proceedings, in order not to definitively lose those credits. For that purpose, creditors are granted with the term of one month to file their respective claim or writ of communication of credit from the day after the publication of the Declaration of Insolvency on the Spanish State Official Gazette. Foreign creditors should receive a notification in their registered address informing them of the Declaration of Insolvency. Nevertheless, as far as the one-month term to file the communication of credits is concerned, the relevant date is still the date on which the Insolvency Proceedings are published in the Spanish State Official Gazette.

42. However, that burden has exceptions under the provisions of amended Section 86.2 of the SIA, according to which the Creditors List must include the claims that have been recognized by an arbitral award or judicial ruling, even if they are not final, as well as those that have been registered in documents with executive force, those recognized by administrative certification, those secured with an *in rem* security entered at a public register, and the claims of employees whose existence and amount are recorded in the books and documents of the Debtor, or that are evinced in Insolvency Proceedings for any other reason (but some of these claims may be nevertheless challenged by the Insolvency Administrators as provided for in the mentioned Section 86.2 of the SIA). Thus, the creditors that are ready to evidence the existence of their credits with one of those documents will not definitively lose their credits, even if they have not been communicated complying with the following rules.

2. Formalities and deadline to communicate credits.

43. The writ should state the name, address and other identifying data of the creditor, as well as those related to the claim, its reason, amount, dates of acquisition and maturity, characteristics and classification intended.

44. The Act 38/2011 introduced important novelties to simplify this process. Creditors must now lodge their writs directly before the Insolvency Administrators and they can do it even via e-mail.

45. However, it remains our recommendation to do it in writing, enclosing as many original attached documents as possible, in order to defeat in advance any possible opposition from the Insolvency Administrator and to reliably evidence the date of reception.

46. Additionally, it is our view that in economically relevant cases, although it is not compulsory either, in parallel to the lodging of the writ before the Insolvency Administrator, the option of appearing before the Court as an interested party still

exists, and it entails the advantage of having access to the whole file of Insolvency Proceedings, thus being duly informed of any developments in those proceedings.

47. Deadline for the communication of credits is set at a one (1)month term or, in some cases, a fifteen (15) day term will be granted to all creditors to lodge their credits, starting from the day after the publication of the Declaration of Insolvency at the Spanish State Official Gazette (see section V above). A late communication of credits will generally mean a subordination of the credit with the abovementioned exceptions.

3. Classification of credits

48. The SIA, taking into consideration the principle of *par conditio creditorum* —which defends the equal treatment of all creditors—, establishes a ranking of credits paramount to creditors since it will provide them with higher or lower expectations of recovering the whole amount of their claims. Those credits are fully integrated in the Insolvency Proceedings, thus called "within-the-proceedings" (*concursales*) and they are to be paid with the estate in an orderly liquidation of such estate and to be paid in their legal order.

49. However, some credits will be drawn directly and immediately from the estate (*créditos contra la masa*) and thus are not fully integrated in the Insolvency Proceedings, as they are super senior (except from those specially privileged credits that will seize their security exclusively, as a rule).

50. The *classification*[7]*, or legal*[8] *order or seniority of payment of the within-the-proceedings credits* set forth in the SIA is as follows:

    i. *Privileged credits:* Junior to "the credits against the estate" but senior to any other credits that can be either Specially Privileged or Ordinary Privileged:

    a. Specially privileged credits. Their privilege is absolute —even to the "credits against the estate"— but only cover the value of the security:

        i. Credits secured with a mortgage, or lien on mortgaged or pledged assets based on registry instead of possession (privilege of seizure of the secured registered asset).

        ii. Credits secured with antichresis (privilege of seizure of the secured fruits).

        iii. Refactionary credits including those of employees (privilege on objects manufactured by them while those assets stay in property or in possession of the Debtor).

        iv. Credits for financial leasing quotas or installment purchase of moveable or immoveable assets, in favour of the lessors or sellers and, when appropriate, the financers (privilege on assets leased with reservation of title, with prohibition on disposal or with a termination condition in the event of failure to pay).

[7] Please note that the Sections referring to the Classification of Credits have been profoundly amended by the 38/2011 amending the SIA.

[8] The agreements of subordination are valid, but not the agreements of privilege that are not effective against other creditors within the Insolvency Proceedings.

v. Credits guaranteed by securities represented by book entries (privilege of seizure of the securities).

vi. Credits secured by notarial pledge, based on possession instead of registry (privilege on assets as long as their possession remains). In case of pledge over credits, the possession is replaced by notarized documents with reliable date of issuance. However, registry is also advisable for these pledges over credits according to the special rules of pledge of future credits, particularly because of the discussions raised by Act 38/2011 amending the SIA.

b. Ordinary privileged credits: Their privilege is just a general preference. They are to be paid after the credits against the estate but before any ordinary credit:

i. Salaries and compensations for early termination of labour contracts that are not recognized as especially privileged up to a special protected amount.

ii. The relevant amounts for tax and Social Security withholdings owed by the insolvent Debtor in fulfillment of a legal obligation.

iii. Claims for freelance work and those due to the author itself for the vesting of exploitation rights of works protected by copyright, accrued during the six months prior to insolvency being declared open.

iv. Tax claims and Social Security claims not specially privileged and only up to half their amount.

v. Compensation for damages and compensations to the revenue from white-collar offences.

vi. Fresh money from Refinancing Agreements under the provisions of Section 71.6 SIA, for the 50% not to be paid as credit against the estate.

vii. The claims held by the creditor who has applied for the insolvency to be declared and which are not subordinated, up to half their amount.

ii. *Subordinated Credits among others:*

a. Claims that, not having been duly communicated by the creditor, are included lately in the list of creditors by the Insolvency Administrators or by the Court on settling a challenge of that list; except for that above-mentioned credits that will be automatically integrated in the Creditors List, even though lately communicated, under the provisions of amended Section 86.2 of the SIA.

b. Claims that, under a contractual arrangement, are subordinated in nature with regard to all the other claims filed against the Debtor.

c. Interest claims of any kind, including those interests or any other form of extra charges for late payment, except for those claims with a security *in rem*, up to the sum of their respective guarantee.

d. Claims for fines and other monetary penalties.

e. Claims held by any of the persons especially related to the Debtor (i.e. directors or shareholders, companies of the same group as the Debtor, etc.).

f. Claims arising from a rescinded agreement when it has been declared that the creditor has acted in bad faith (see VI *f* below).

g. Claims arising from the contracts with reciprocal obligations, which the creditor has repeatedly hindered fulfillment of the contract to the detriment of the general interest of the creditors.

According to the provisions of Section 89.3 of the SIA, all other claims not classified as privileged or subordinated will be understood to be classified as ***ordinary claims***, being thus payable after credits against the estate, after general privileged credits, before any subordinated credits and at the same time of the specially privileged credits over the part not covered by the *in rem* security.

iii. *Credits against the estate* (*"Créditos contra la masa"*) are super senior (except to the specially privileged credits that, as a general rule, will exclusively seize their security exclusively).

Only creditors within the specific cases listed in Section 84.2 SIA are entitled to those credits. The cases are summarized as follows:

1. Wages for the last thirty days prior to commencement of Insolvency Proceedings in an amount not exceeding double of the minimum interprofessional salary.

2. Judicial costs and expenses.

3. Costs of maintenance for the Debtor and of persons to be maintained *ex lege*.

4. Costs generated by the exercise of the professional or business activity of the Debtor after the Insolvency Proceedings are declared open.

5. Costs arising from services provided by the insolvent Debtor under reciprocal contracts and obligations pending fulfillment that remain in force after Insolvency Proceedings are declared open.

6. Costs deriving from payment of claims with special preference, rehabilitation of contracts or stoppage of eviction.

7. Costs corresponding to insolvency revocations of acts performed by the Debtor.

8. Costs arising from obligations validly contracted by the insolvency administrators during the proceedings, or with their authorization or approval, by the insolvent Debtor subject to intervention.

9. Costs arising from legal obligations or liability of the insolvent Debtor between commencement of Insolvency Proceedings and effectiveness of the composition or their conclusion.

10. Any other claims pursuant to the SIA.

Those listed cases are essentially credits arising as a result of the Insolvency Proceedings or for the sake of the continuity of the Debtor´s activity. Hence, they are strongly protected to favour the continuity of the economical activity of the insolvent, in interest of all creditors.

In particular, regarding continuing contracts, and according to most of the precedents and authors, the contractual features born before the Declaration of Insolvency will be contained in the List of Creditors and those that arise after the Declaration of Insolvency will be drawn from the estate. This applies in both cases if the contract is legitimately terminated and if it is still binding. However, this joint interpretation of Articles 61, 62 and 84 of the SIA is not uncontested, and certain scholars or isolated judicial precedents consider that the *in bonis* party should be paid directly from the estate for the whole accrued debt when a continuing contract is terminated with grounds based on a contractual breach subsequent to the Declaration of Insolvency.

The court hearing the Insolvency Proceedings will have exclusive jurisdiction to hear any claim regarding those super senior credits or even their enforcement. That enforcement is lawful after the first year of Insolvency Proceedings or an earlier opening of the winding-up phase or composition of creditors. In some cases, the insolvency administrator is entitled to alter the normal seniority of the credits against the estate (based on their maturity date).

iv. *Credits of special treatment:* Section 87 SIA sets forth some particular regulations of credits regarding recognition of claims. Hence, Section 87 SIA provides regulation for (i) conditional credits, such as the ones containing a clause of denunciation; (ii) contingent credits, such as those with a condition precedent or which amount is to be determined by means of administrative decision or judicial proceedings and; (iii) special cases of guarantees where the insolvent is the guarantor or the guarantee.

4. List of credits by the Insolvency Administrator. Its challenge

51. Once the Insolvency Administrators have received all the creditors' claims or writs of communication of credit and have gathered the Debtor´s relevant documentation, they will elaborate a Provisional Creditors List according to Section 94 SIA.

52. However, any creditor who disagrees with the classification or amount of the credit acknowledged by the Insolvency Administrator can challenge this decision within the ten (10) day term provisioned on Section 96 SIA. Another novelty introduced by the amendment of the SIA is that an extraordinary chance of claim is made available for certain creditors who were not able to file the writ of communication of credit before the drafting of the Provisional Creditors List. Other extraordinary amendments of the Provisional Creditors List in the Definitive Creditors List are also provisioned on the newly introduced Section 97 bis SIA. Notwithstanding those extraordinary amendments of the Provisional Creditors List, the Definitive List is normally the Provisional list with the corrections awarded by the Commercial Court to the challenges presented by creditors.

5. Other effects: compensation, accrual of interests, etc.

53. Once the Insolvency Administrators have received all the creditors' claims or writs of communication of credit and they have gathered the Debtor´s relevant documentation, they will elaborate an Interim Creditors List (see section VI *a* above),

54. The SIA establishes a general prohibition of the compensation of credits and debts of the insolvent, exceptionally accepting it in those cases where the requirements for the compensation have been satisfied before the Declaration of Insolvency. However, Royal Legislative Decree 05/2005 sets forth a special system for financial entities.

Any dispute arising from the compensation will be heard by the Insolvency Court in a special procedural plea.

55. Regarding interests, the commencement of Insolvency Proceedings will entail that accrual of legal or contractually agreed interests will be suspended, except for those linked to obligations guaranteed with securities *in rem*. In respect to secured obligations, interests will carry on accruing up to the maximum amount set forth in the deed of security.

56. In the case of salary claims, the suspension of accrual of interests will not operate.

57. Other important effects of the declaration of insolvency over credits are:

    - Creditors lose any retaining or possessory lien ("*Derecho de retención*") over the property of the Debtor.

    - The interruption of the limitation period of any claim of credit against the Debtor, but not of the actions against its guarantors, as well as of any claim against directors and, in general, of the actions suspended during the Insolvency Proceedings.

***d. Effects on Enforcement Proceedings and Enforcement of Securities* in rem**

58. One of the most important changes addressed by the SIA is the special treatment given to enforcement proceedings and enforcement of securities *in rem*. The inherent nature of the *in rem* security is respected but some restrictions are imposed on the creditor to ensure that the separate enforcement of the lien neither disturbs the proper course of Insolvency Proceedings nor prevents it from solutions that may be convenient to the interests of the Debtor and of the aggregate liabilities.

59. In general, once Insolvency Proceedings start, no judicial or out-of-Court civil enforcement against the Debtor may be initiated and any action in process shall be suspended from the date of the Declaration of Insolvency. Public creditors (i.e. State, Inland Revenue, etc) have a more favourable treatment. Furthermore, the Insolvency Administrator has active legal standing to claim in the Insolvency Court for the removal of any seizure of assets of the Debtor, as a consequence of pending enforcement proceedings, in the interest of the Insolvency Proceedings. The Court will hear also the aggrieved creditor.

60. As to securities *in rem* (in general, mortgages or pledges over goods, rights or receivables), once proceedings have commenced, secured creditors:

    - Will not be entitled to foreclose or forcibly release the guarantee until a composition of creditors is reached (the content of which does not affect the exercise of the enforcement) or until one year elapses from the date of commencement of proceedings.

    - Will also have their enforcement proceedings suspended until the composition of credits is agreed or one year has elapsed from the Declaration of Insolvency.

    Unless (1) those creditors obtain a declaration stating that the mortgage or asset pledged is completely irrelevant to the commercial activity of the Debtor from the Insolvency Court; or (2) it is evinced that the Insolvent is the owner but not the Debtor of the mortgage or another secured credit; then the foreclosure or enforcement will be completely independent from the Insolvency Proceedings.

    In the first case and, in general, when a foreclosure or enforcement is initiated within an Insolvency Proceedings before the opening of the winding-up phase, these proceedings will

be followed according to the general provisions for those enforcements set forth in the Civil Procedural Act and they will be heard by the Insolvency Court.

Once the winding-up phase is opened, on-going foreclosures and other enforcements over pledges can continue but not be commenced. That means that the mortgage over pledged assets will be liquidated under the normal regulations of that winding-up phase. However, the secured creditor will maintain its privilege over the value of the security as has already been analyzed.

e. Effects on Legal Actions/Proceedings

61. The commencement of Insolvency Proceedings will inevitably have effects on legal actions and proceedings commenced in other jurisdictions such as civil, contentious-administrative or employment, as well as on arbitration proceedings. The following effects will occur:

62. Applications corresponding to Civil and Employment Courts will be instead heard by the Commercial Court pursuant to the provisions established in this Act. In case such applications are lodged before Civil and Employment Courts, these must abstain from hearing them, warning the parties to avail themselves of their right before the Insolvency Court. Any proceedings should be set aside; otherwise, they will be null and void.

63. Additionally, actions of joint liability against directors must be, pursuant to the amended SIA, stayed during the handling of the proceedings (see above section VIII), as happens with direct claims of subcontractors against the commissioner of a turnkey agreement (avoiding the filing of a claim against the Insolvent as the contractor to that commissioner) according to the provisions of Section 1,597 of the Spanish Civil Code. Other liability against directors will have limited legal standing for the Insolvency Administrators (see above section VIII).

64. Courts of law for the contentious-administrative, employment or criminal jurisdictions before which actions that may be of a great significance to the assets of the Debtor are brought after the Declaration of Insolvency will summon the Insolvency Administrators and admit them as a party to defend the estate, if they deem it appropriate to appear;

65. Any declaratory proceedings in process at the moment of commencing the Insolvency Proceedings in which the Debtor is a party, will continue to be heard by the same court, which is a different court from the Insolvency Court, until the ruling is final, with the exception of the existing claims against the Insolvent Directors that will be joined to the Insolvency Proceedings;

66. On-going arbitration proceedings at the moment of declaring the Insolvency Proceedings open will continue until a final award is rendered.

67. All the rulings and arbitral awards rendered by any court, different from the Insolvency Court will be binding to the Insolvency Court.

68. In the event of the suspension of the Debtor's powers of management and disposal, the Insolvency Administrators, within the scope of their powers, will substitute it in the ongoing judicial proceedings, to which end they will be granted, once they have appeared, a term of five (5) days to study the proceedings, although they will need the authorization of the insolvency Court to waive the lawsuit either fully or partially, or reach a compromise. Additionally, the Insolvency Administrators will also substitute the Debtor in the new judicial proceedings, thus holding the active legal standing for any claim in the name of the Debtor and in the general interest of the creditors. Any creditor may request this exercise of actions

by the Insolvency Administrators and, if there is not a positive response within the following two months, they may exercise the action by themselves in the general interest of the creditors, but at their expense.

69. However, in the event of intervention, the Debtor will preserve the capacity to act in trial, although it will require authorization by the Insolvency Administrators to fully or partially waive a lawsuit or agree on a transaction within the proceedings when the subject-matter of litigation may affect its estate;

f. Effects of Rescission in Insolvency

70. Section 71 of the SIA is of paramount importance since it introduces the possibility of rescinding certain acts carried out by the Debtor during the two (2) year period preceding the Declaration of Insolvency, on the grounds that those acts are prejudicial to the insolvent estate and regardless whether those acts had been performed with the aim of deceiving the interests of the creditors or not. Within the Insolvency Proceedings, the Debtor´s acts or agreements that are considered to be detrimental to the estate and that have been carried out during the two (2) years preceding the Declaration of Insolvency, will be rescinded even in the absence of fraudulent intention.

71. The provisions of Section 71 of the SIA are, in particular, aimed at: (i) ensuring that the insolvent's estate is not reduced to the detriment of its creditors; and (ii) safeguarding the *par conditio creditorum* in Insolvency Proceedings.

72. It is absolutely assumed, *iuris et de iure*, that the damage to the estate has been caused by the Debtor in the event of actions of disposal without consideration (except for usual liberalities), and payments or other actions aimed at discharging obligations with an original date of maturity subsequent to the date of the Declaration of Insolvency, except in the case of a secured credit, as we will immediately see.

    Furthermore, detriment is presumed but it can be rebutted in the event of (i) disposal actions carried out in favour of a party related to the insolvent party; (ii) the creation of securities *in rem* in favour of pre-existing obligations or new obligations replacing the obligations previously existing; and (iii) payment to a secured creditor (with pledge, mortgage, etc) before the maturity date.

    Finally, in the case of actions not included in any of the above two categories, the detriment must be evidenced by the person bringing the action of rescission.

    However, the SIA sets forth some ironclad payments and agreements that in no way will be rescinded: (a) ordinary acts and contacts, usual in the particular market and under normal market conditions; (b) compensations and payments under the provisions of special regulations of securities and finance (*i.e.* Royal Legislative Decree 05/2005.); (c) securities to guarantee public credits; and (d) ironclad Refinancing Agreements when they meet the above mentioned requirements.

73. The claim of rescission is heard in a special procedural plea. In case the discussed matter is a Refinancing Agreement, only the Insolvency Administrator has legal active standing, not any creditor.

74. The effects of rescission under Section 73 of the SIA are the following: (i) the ineffectiveness of the act; and (ii) the restitution of the goods or services provided by the parties involved in the act that is rescinded, plus interests and other benefits, if any.

If the rescission is declared but the Debtor can no longer return the goods or services received to the creditor, the creditor will receive, as a rule, monetary compensation drawn from the estate. At the same time, the creditor will return what it received from the debtor.

Notwithstanding the above, if the court declares the creditor has acted in bad faith, it will receive that monetary compensation within the Insolvency Proceedings and as subordinated credit.

The special claim of rescission under the provisions of Sections 71-73 SIA does not deprive creditors of all ordinary remedies against fraud.

VII. Termination of the Common Phase: Composition of Creditors, Winding-up, or Declaration of Insufficient Estate

75. Insolvency Proceedings will unavoidably end in one of the following ways: either the Debtor reaches a composition with its creditors, it is wound-up, the insolvency is terminated due to insufficient estate or the creditors are fully paid by the Debtor or a third party.

a. *Composition of Creditors*

76. In the course of Insolvency Proceedings, it is the will of the legislator that the Creditors must attempt to reach an Agreement with the Debtor by means of a "Composition of Creditors". Hence, reaching such agreement will ensure that the Debtor will be able to carry out its business without an eventual winding-up.

77. The SIA establishes two types of Compositions to be reached.

78. Firstly, it provides the possibility of submitting an Early Composition Proposal (ECP). ECPs are to be filed by the Debtor that has not applied for winding-up, between the time period of the request for Insolvency Proceedings and the deadline for communication of claims. Secondly, an Ordinary Composition of Creditors may be reached. In case that the Common Phase ended without the Debtor´s application for the Winding-up Phase, the court will call a Creditor's Meeting to try to reach a composition so as to avoid the winding-up. Both the Debtor and Creditors (representing at least 1/5 of liabilities) are entitled to submit proposals of ordinary composition of credits to be discussed in that meeting.

79. Early and ordinary compositions of credits have a different procedure to be voted on and then judicially approved. In every case, the Insolvency Administration must evaluate the Proposal and the Court will then approve the Composition of Creditors.

80. In the case of an ECP, once it has been evaluated, if no opposition has been made to such proposal and if the majority of creditors have adhered (in writing) to it and no alternatives have been submitted to the Court, the Court will have the authority to approve the proposal and it will be effective immediately, without the need to call for a Creditors' Meeting ("*Junta de Acreedores*").

81. On the other hand, in case of an Ordinary Composition of Creditors, Creditor's Meeting will be called in order to oppose or adhere to it. Nonetheless, in those cases where the number of Creditors is above 300, written adhesions may be filed to the Creditor's Meeting, thus exempting Creditors from attending to it.

82. In order for the meeting to accept a proposal of composition, favourable voting of at least half the ordinary creditors is required. Please note that subordinated creditors do

not have voting rights[9]. Privileged creditors only vote regarding their credits because the composition of credits does not affect them, but they could waive their security (and therefore, their privilege of credit) and then vote as an ordinary creditor.

83. However, when the proposal is (i) to postpone the payment of the ordinary credits up to three years, or (ii) to reduce the credits by up to twenty per cent (and with immediate payment), it will suffice to have more votes (regarding the amount of the credits) in favour of the proposal than against it.

84. In cases of written proceedings, the creditors who oppose these proposals must, when appropriate, formulate their negative vote following the procedure established for positive adhesions pursuant to Section 103 of the SIA and within the deadlines provided in Sections 108 and 115 bis of the SIA.

b. ***Winding-up***

85. The winding-up phase, or the winding-up alternative, may be triggered either by: (i) the Debtor, voluntarily, as is the case here; (ii) by the creditors if a Composition of Creditors is not reached; or (iii) by the court if no proposal of Composition of Creditors has been submitted, if none of the proposals has been accepted, or if the Composition of Creditors is declared null or in breach by a court resolution.

86. There are two main novelties introduced by the last amendments of the SIA regarding the opening of the winding-up phase within the Insolvency Proceedings. Unfortunately, the connection between them is unclear at this stage: The amended Section 142.1 of the SIA entitled "Opening the winding-up at the request of the Debtor or creditor or the Insolvency Administrators" establishes that the Debtor may petition for winding-up at any time and that within the next ten (10) days the Court must issue a Court Order opening the winding-up phase.

87. However, a new paragraph has been introduced in Section 96 of the SIA stating an exception to the rule pursuant to which the common phase must be ended before the opening of the Composition of Creditors/Winding-up phase proceedings. When the challenges affect less than 20% of the inventory and the Creditors List, the Court may put an end to the common phase of the Insolvency Proceedings.

88. Therefore, there are doubts as to how these two articles are to be interpreted with regards to the other. A literal interpretation of Section 142.1 of the SIA seems to state that in cases where the Debtor files for Insolvency and it requests, at the same time, the winding-up, the winding-up phase would immediately start, without waiting for the Debtor's assets and debt to be determined. It is unclear whether this article should be read separately or together with Section 96 of the SIA, which states that winding-up may not begin until the term to lodge incidental writs has expired, and only if those writs lodged affect less than 20% of the inventory and the Creditors List. A possible hypothesis is that the Court may order the commencement of the winding-up phase only with regards to the liquidation of assets, without paying the creditors until the list and order of priority have been determined.

89. Once the winding-up has been decided, the Insolvency Administrators will present a liquidation plan to dispose of all the properties, goods and rights comprised in the Debtor's estate, which will be presented to the Debtor and the employees' representative, if any, for review and proposal of amendments, if they deem it appropriate.

[9] As it happens with the creditors that had acquired their credits after the Declaration of Insolvency.

90. The aim of the SIA in the winding-up phase is to try to dispose of all the Debtor's assets as a whole, unless it is in the insolvency's interest to act otherwise. In any event, the assets are disposed of following the general Rules of Civil Procedure, i.e. they are disposed of in public auctions and with the prohibition to the Insolvency Administrators to acquire any of the Debtors' assets.

91. The opening of the Winding-up phase has a number of consequences:

- The powers of management and disposal of its estate will be immediately suspended and conferred to the Insolvency Administrators.

- It gives rise to the early maturity of all credits within the Insolvency Proceedings and it will turn the pending services into money, delivery of goods, or any contractual obligation of the Debtor.

92. Insolvency Proceedings, in the case of winding-up, end when the assets have been disposed of, creditors have been satisfied in accordance with their credit rankings and the principle of *par conditio creditorum* and the winding-up of the Debtor have been recorded at the Commercial Registry.

c. ***Termination Due to Insufficient Estate***

93. The amendment to the SIA has brought about a new way to end the Insolvency Proceedings when there is insufficient estate. This case is similar to a winding-up but the proceedings are terminated at the very beginning, without waiting for more assets to show up in the course of the Insolvency Proceedings, nor putting forward a plan for the winding-up. Basically, credits against the estate are paid with the available assets following the special order of priority which is different from the general rule established in the SIA (see section VI *c* above).

d. ***General payment of creditors***

94. In exceptional cases, where there is no need of a composition of creditors or a winding-up, due to an out-of-court agreement or to the intervention of a third party (*i.e.* a parent company avoiding any possible liability of itself or of its directors), the Debtor is able to fully pay all its debts or to obtain a general renouncing of its creditors. In such cases, Insolvency Proceedings are ended by means of a judicial decision under the provisions of Section 176 of the SIA.

VIII. Liability of the Company´s Directors

95. Pending the Insolvency Proceedings, the possibility to undertake legal actions against its Directors is subject to a specific regulation. These actions may be brought forward within the framework of Insolvency Proceedings or as a separate civil action. After the SIA's amendment, the following hypothesis of liability can be considered:

a. ***Classification of the Insolvency as Tortious***

96. The opening of the winding-up phase or the termination of Insolvency Proceedings with a composition of credits involving discharge of debts in more than 1/3 or the stay of payments for more than 3 years will give rise, among others things, to the opening of the insolvency classification procedural plea (*Sección de Calificación de la Insolvencia*).

97. The Court's judgment will declare the insolvency as fortuitous or tortious.

a. Fortuitous Insolvency

This kind of Insolvency is triggered by the Debtor's distressed financial situation, which arose in its normal course of business.

b. Tortious Insolvency

In this case, the insolvency situation has arisen from a malicious intent or grave negligence of the Debtor's management, which has subsequently aggravated its financial situation. With regard to this matter, the SIA provides (i) a general rule according to which certain circumstances, if evinced, determine the classification of the Insolvency Proceedings as tortious and (ii) a series of presumptions of the insolvency being tortious, some of them *iuris et the iure* or absolute and others *iuris tantum* hence, rebuttable. This is examined below:

i. *General Rule*: The insolvency will be classified as tortious when the generation or aggravation of the state of insolvency has involved malicious intent or gross negligence by the Debtor or his legal representatives, if it has any, or, in the case of a legal person, its *de iure* or *de facto* directors or liquidators.

ii. *Presumptions*: The SIA lays down certain presumptions on the director's liability.

In the first set of circumstances, the insolvency is classified as tortious in any case i.e. there will be no need to evidence the facts, when any of the following cases arise:

- When the Debtor legally obliged to keep accounts substantially breaches that obligation, keeps double accounts, or has committed a material irregularity impending adequate comprehension of the subjacent economic or financial situation.

- When the Debtor has committed a severe misrepresentation in any of the documents attached to the petition to declare commencement of Insolvency Proceedings or in those documents submitted during such proceedings, or when it has attached or submitted false documents.

- When opening the winding-up has been resolved by a Court acting on its own motion due to breach of the composition for causes due to the insolvent Debtor.

- When the Debtor has embezzled all or part of its assets to the detriment of its creditors, or it has performed any act that delays, hinders, or prevents the effectiveness of a seizure of any kind of enforcement commenced or whose commencement is foreseeable.

- When, during two (2) years prior to the date that the Declaration of Insolvency has been declared open, properties, goods or rights have been fraudulently detracted from the Debtor's estate.

- When before the date on which Insolvency Proceedings are declared open, any legal act aimed at simulating a fictitious state of assets has been performed.

Furthermore, the existence of malicious intent or gross negligence will be presumed, in the absence of evidence to the contrary, when the Debtor, or if appropriate, its legal representatives, directors, or liquidators:

- Has breached the duty to petition for a declaration opening Insolvency Proceedings.

- Has breached the duty to collaborate with the court in charge of Insolvency Proceedings and the Insolvency Administrators have not provided them with the necessary or convenient information for the interests of Insolvency Proceedings, or they have not attended the creditors' meeting, personally or by means of proxy.

- Or, if the Debtor who is legally bound to keep the accounts has not formulated the annual accounts, has not submitted them to audit when being bound to do so, or, once approved, it has not deposited them at the Commercial Registry in any of the three (3) business years preceding insolvency being declared.

98. The following persons (individuals and/or legal entities) may be held liable, under the SIA, for the insolvency or its aggravation:

    - Debtor.

    - *Officially appointed directors*[10]*, liquidators and legal representatives* of the legal person whose insolvency is classified as tortious, and those who have acted as such during the two (2) years prior to the date of declaring the insolvency.

    - De facto *directors:* a person who discharges the functions of a director without doing so by virtue of a formal appointment will be considered to be *de facto* director and has acted as such during the two (2) years prior to the date of declaring the insolvency.

    Additionally, those persons who, with malicious intent or gross negligence, have aided the Debtor, or its general proxies, or its directors or liquidators, both *de iure* and *de facto,* in the performance of any act that has led to the insolvency being considered as tortious will be deemed accomplices of that tortious insolvency.

99. The Ruling of the Court will declare the insolvency as fortuitous or tortious. In the latter case, the court will state the cause or causes on which the classification is based. This ruling classifying the insolvency as tortious must also contain the following pronouncements:

[10] In accordance with the case-law of the Barcelona Commercial Courts, where the managing body is a collective body (Board of Directors), each of the members will be liable for their own acts and it will be necessary to prove the malicious intent or gross negligence of each of the members.

- Establishment of the persons affected by the classification, as well as, when appropriate, those people who are declared accomplices. If any of the persons affected was acting as a *de facto* director or liquidator of the Debtor when a company and not and individual, the ruling must reason the attribution of that condition.

- Barring of persons affected by a classification to administer third-party's goods for a period ranging from two (2) to fifteen (15) years, as well as to represent or manage any person during that same period, in all cases according to the severity of the facts and the scope of the damage.

- The loss of any right that the persons affected by the classification or declared accomplices may have as insolvency creditors or against the aggregate assets and the order to return the properties, goods or rights they may have unduly obtained from the Debtor's estate, or that they may have received from the aggregate assets, as well as to indemnify for the damages and losses caused.

100. When the Classification Section has been formed or reopened as a consequence of the opening of the winding-up phase, the ruling may also condemn the *de iure* or *de facto* directors or liquidators of the legal person whose insolvency is classified as tortious, and those who have acted as such during the two (2) years prior to the date of declaring the insolvency to pay the insolvency creditors the full or partial amount of their claims that they did not receive from the liquidation of the aggregate assets.

b. Collective action

101. Apart from the specific procedural plea to classify the Insolvency as Fortuitous or Tortious, the general collective action with grounds on the Spanish Capital Enterprises Act (hereinafter, the **CEA**)[11] may be initiated against the company's directors. However, as set forth in Section 47 during Insolvency Proceedings, this action may be only carried out by the Insolvency Administrators.

c. Liability on the company´s directors: individual action

102. An "individual directors´ liability action" can usually be carried out by the members of the company but also, by third parties who have experienced damages as a result of the mentioned negligence. The compensation obtained will not be added to the assets of the company but it will be directly paid to compensate the damages suffered by the affected individual[12]. However, the recently amended law is unclear

[11] According to provision 238 of the CEA.

1. Action to demand director liability shall be brought by the company pursuant to a general meeting decision, which may be adopted at the behest of any shareholder even where not included on the agenda. The by-laws may not require a qualified majority for the adoption of such decisions.

2. The general meeting may reach a settlement in or waive such action at any time, unless an objection is raised thereto by partners representing five per cent of the capital.

3. The decision to bring action or reach a settlement shall entail dismissal of the directors concerned.

4. Approval of the financial statements shall not preclude action for liability nor constitute a waiver of the action agreed or brought.

[12] According to provision 241 of CEA "actions for indemnity that may be incumbent upon partners or third parties for directors' action that is directly detrimental to their interests shall be excepted".

on this matter and scholars discuss if this action, under the amended provisions, may still be carried out independently from Insolvency Proceedings (and thus be brought before a different Court).

d. Directors' Joint Liability for Any Debts incurred After Breaching the Obligation to Dissolve the Company

103. The CEA establishes that Directors must call a mandatory general meeting within two months from the date on which they realize that the company is insolvent[13]. Unfortunately, actions of joint liability against directors must be, pursuant to the modified SIA, stayed during the handling of the proceedings. In other words, they cannot be initiated after the Declaration of Insolvency and they will be suspended until termination of Insolvency Proceedings.

[13] Section 367. Joint liability of the directors

1. Directors who fail to convene the mandatory general meeting within two months to adopt the decision on winding up, as appropriate, shall answer jointly and severally for corporate obligations incurred after the legal cause for winding-up is forthcoming. Directors who fail to apply for a Court ruling to wind up the company or, as appropriate, to institute Insolvency Proceedings within two months of the date scheduled for the meeting, when it was not held, or from the day of the meeting, when the winding-up proposal was defeated, shall be equally liable.

2. In such cases, corporate obligations constituting the object of claims shall be regarded to be subsequent to the legal cause for winding up the company unless the directors can substantiate that they are dated prior thereto.

For any queries on the above please contact any of the following members of Gómez-Acebo & Pombo:

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