Spain Worked Out: Spain’s reforms wish list

21 January 2020 Kyriaki Karadelis

Madrid, Spain (Credit: shutterstock.com/Sean Pavone)

A new, consolidated Insolvency Act and the forthcoming transposition of the European preventive frameworks directive offer opportunities for change in Spain. But Spanish practitioners have other issues on their wish lists for reform too, including specific tweaks to the legislation to clarify points of contention, and broader desires, such as better resourcing of the Spanish courts.

Ignacio Buil, a partner at Cuatrecasas in London, suggested that now would be a good opportunity to get some statutory clarification on how contingent creditors’ claims should be treated in homologation proceedings. In the Abengoa and FCC restructurings, courts in Seville and Barcelona respectively said that contingent claims did not count as financial liabilities that could be subjected to homologation. But until the matter is codified in law, the debate rumbles on.

Also at Cuatrecasas, **Javier Castrodeza** in Barcelona wants clarity on the selling of productive business units as a restructuring tool, after a number of “not very helpful” court decisions over the past two years ordering new buyers to pay all of the original debtor’s labour rights. These decisions have been at odds with the rest of the Spanish legislation, which is meant to allow new buyers to buy distressed businesses free and

clear of liabilities. "In the future the legislature has to review this situation, because it's a very good way to save companies and workers and economies," Castrodeza said.

José Carles at Carles Cuesta wants the same: "It's true that you need a real solution for sale of productive units, which doesn't really work at the moment," he says, adding that assumption of liabilities towards the workforce is putting buyers off acquiring productive units. "Lots of opportunities are lost to sell the activity as a whole, and in the end what happens is that it is liquidated so someone buys just assets at a much cheaper price."

Carles also suggests improving the regime for pre-pack sales in Spain, where it is "complicated" by the fact that directors can be liable for sales transactions made in the two years prior to insolvency proceedings. So if the director sells off part of the business and remains with the other part, which then thrives, everything is okay – but if the other part of the business ends up insolvent anyway up to two years down the line, the director could be in trouble. The way to avoid this is by asking a third-party independent expert to write a report that the sale was completed under market conditions and for a fair price at the time it was made. Then if the director does get into trouble, he or she can show the sale was good business.

"In other countries this is very well regulated and people aren't worried about their liability, but in Spain it's one of the big issues," Carles tells GRR. "When I meet other lawyers from abroad, pre-pack sales are very well defined. They are more common. In Spain, unluckily, they are not so much. Normally the directors will look for funds to be injected, or capital increase – if it's for subsidiaries, the mother company will inject more capital – but these are resolutions until one day they say, 'OK, I'm going to inject no more cash in here'."

"It would make a lot of sense [to have pre-pack sales] because you're selling it in the moment when it's at its best," Carles said.

Extra-EU recognition

Other lawyers suggested the process for recognition of foreign insolvency proceedings outside the EU could be easier, but they said it was unlikely Spain would be adopting the UNCITRAL Model Law on Cross-Border Insolvency any time soon.

For intra-EU insolvency proceedings, the European Insolvency Regulation provides automatic recognition in Spain, but for proceedings outside the member states, Spanish law only provides for a regular exequatur process for the recognition of foreign court judgments.

Linklaters counsel **Juan Oñate Dancausa** in Madrid says the exequatur process is generally well regulated and effective. The only part that sometimes causes an issue is the requirement to notify the filing to companies abroad. "That sometimes involves a delay because you need to be sure the defendant has received the claim," he says. "But it works very well and it's been used a lot."

Partner **Juan Barona**, also at Linklaters, says the process works better depending on which countries are involved. Notifying a filing in Russia and recognising a Russian judgment, for example, can be very difficult.

The exequatur process also takes a lot more time and is more expensive than a regular automatic recognition process under the European Insolvency Regulation. "Of course the defendant can always say that it was not filed, that the court that rendered the judgment had no jurisdiction – you know, use tricks to delay things," Dancausa says.

Despite the difficulties posed by the absence of a formal insolvency recognition process for proceedings outside the EU, there does not appear to be much appetite in Spain for adoption of the UNCITRAL Model Law. "I don't think there's a perception that there is a proper need for that," says Linklaters partner **Pedro De Rojas**. "In the recent cases there has been a local solution. Obviously these changes to the law always need a lot of political support behind them and in the last years we haven't had any strong proper government."

But Carles says the UNCITRAL Model Law's existence has been helpful in the past, even if it has never been adopted internally. He advised shipping company Korea Line Corporation when it sought recognition in Spain, and recalls that South Korea's adoption of the UNCITRAL Model Law was one of the bases the Spanish court used to recognise the foreign insolvency.

"The fact they were part of the UNCITRAL Model Law and had adopted it helped us make the court see [South Korea] complies with minimum rights to creditors, and they don't provide a differentiated regime for creditors that are inside and outside the jurisdiction, which is basically the basis for recognition," Carles explains.

The presence of the Model Law, and the fact that courts in Canada, the US and the UK had recognised the South Korean case in the meantime, meant the "quite fast" process took six months, according to Carles. Korea Line Corporation initially sought recognition in Spain in March 2011, and the recognition came in November. Carles adds that this required a long preparatory process of obtaining the South Korean court judgment initiating the insolvency, getting everything translated and submitting an expert report from two lawyers on Korean law. Once the Spanish court had confirmed it had everything it needed for a proper filing, however, it took a month to issue its decision.

"The shipping company was of course having ships coming through the Mediterranean and they were worried that if they came through Spanish waters and there were creditors in Spain, they would initiate enforcement actions against the ships that were under Spanish jurisdiction," Carles recalls. "I think Spain should adopt the UNCITRAL Model Law because it will help to have faster recognitions, and it would also help a lot with precautionary measures – for example, to have temporary recognition before a full ruling on recognition comes."

He argues it would also make sense because the UK and the US have adopted the Model Law, and because it would also make things easier for recognising insolvencies in South America and other Spain-related jurisdictions in the Caribbean. But on the negative side, Carles said UNCITRAL was probably a bit old and in need of reform. "I don't know. I cannot say what politicians [in Spain] are scheming," he laughs. "It's true that there are so many changes in Spain that I think this is the last of the worries of the legislature."

One jurisdiction for which it be essential for Spain to replicate the European Insolvency Regulation regime is the UK after Brexit, Carles says, ideally through some sort of bilateral agreement.

"If the UK goes out of the EU and there's no bilateral agreement that replicates the Insolvency Regulation, from having a system in which the recognition is totally automatic – having a framework that works really well and which makes us be close countries, neighbours – we will have to apply the same regime that I had with South Korea," he laments. "It would be sad if what applies to South Korea is the same regime that will apply to the UK, because the relationships between UK and Spain are much bigger."

Better-resourced courts

Companies in Spain are required by law to file their homologation or insolvency proceedings at the seat of their centre of main interests (COMI). The location of major industries near Madrid and Barcelona inevitably makes those courts the busiest, with almost all practitioners noting that Barcelona's judges tend to lead the way in terms of creativity and commercial nous in the restructuring and insolvency field.

"Madrid, Barcelona – these are the most experienced insolvency courts and they have judges in those cities that specialise in homologation, so that also gives you an advantage," says Jones Day partner **Juan Ferré**, based in Madrid. Ferré says if you apply to courts in either of those cities, you know that one of three judges will be deciding your case, and that helps because they are very knowledgeable in these matters.

Outside the major cities, Ferré says, there is a little more uncertainty on the outcome. But given that Spanish companies can't choose which court they file in unless they shift their COMI six months beforehand, it tends to be that lawyers and insolvency practitioners just adapt to the criteria of the local court where the company is based. There is no noticeable trend of internal COMI shifting, Ferré says.

Dancausa at Linklaters described the courts as "receptive" and said it was generally easy to talk to judges and ask them to explain issues. "The ones dealing with the Spanish schemes are the mercantile courts, so these judges are specifically prepared for leading restructurings and commercial disputes. They are the most prepared judges in Spain," he says. "Even when they have a lot of work, they are normally very good."

Garrigues partner **Adrián Thery** similarly describes judges in Spain as "very technically qualified with a lot of generosity in the time they devote to cases, both to studying and to passing judgments".

"As opposed to other countries, in which one judge can as likely be dealing with divorce or with bankruptcy cases, in Spain commercial judges devote most of their time to bankruptcy, so they are really specialised and well acquainted with economic and financial implications," he tells GRR.

The problem Spanish courts face is one of resources. "The judges are not given all the resources that they could be by the state, and that is a problem to tackle, because bankruptcy judges may really contribute to wealth creation. Whatever happens in insolvency downstream affects the way that investors grant credit upstream. The state should definitely consider whether to provide more human and material resources to bankruptcy judges, because they have a direct relationship with the country's wealth," Thery says.

There was at one time an informal proposal to centralise certain commercial matters under specialist judges in Madrid, but it was ultimately left aside. Soon the multibillion-euro homologation of Spanish conglomerate Abengoa, presided over by **Judge Pedro Márquez Rubio** in Seville, would prove that local courts could handle the pressure.

De Rojas, part of the team advising Abengoa in those proceedings, recalls Judge Márquez and the Seville court's efficiency in that case. "The claim was huge – the number of companies filing and the difficulties [they had] – and he was very quick," he says of Márquez, whose analysis and reasoning De Rojas praises as carefully considered.

In Barcelona, judges have also impressed with their creativity and flexibility in scheme proceedings. Dancausa said Barcelona judges have been "very aware of being proactive with Spanish schemes" and have helped develop the practice more. One such former Barcelona judge is **Ignacio Sancho Gargallo**, now a very well-respected justice on the Spanish Supreme Court and a member of the International Insolvency Institute. Others have recently moved over to the Madrid courts to share some of their experience.

"It's true that Barcelona judges normally have been more open to different ideas," says **Fedra Valencia**, a partner at Cuatrecasas in Madrid, who tells of two judges who have moved from Catalonia to the 11th and 14th Commercial Courts in the Spanish capital. "We have these new people in the market and maybe we'll see change," she added.

Valencia explains that Barcelona practitioners are at an advantage because of the continuity of the staff working at the courts, who have developed knowledge and experience of homologation proceedings and are able to move them along quickly. In Madrid, the staff turnaround has been much higher, with the result that court employees

have not built up quite the same knowledge or understanding of the urgency in some cases.

But Castrodeza warns the Barcelona courts are at risk of losing the experience and talent that Valencia described through judges and staff moving. “They were very open. They were always coordinating their opinions – you could have a single opinion across the 11 courts that we had in Barcelona. Now, we will see,” he laments. “We are probably losing what we had. I would say that Madrid in some cases is more coordinated than Barcelona, unfortunately for us.”

Even though **Javier Rubio Sanz**, counsel at Uría Menéndez, points to a number of experienced judges leaving their posts a few years ago to return to private practice, they have since been followed by a new crop of judges coming through. For example, Uría partner Javier Yáñez was a judge in Commercial Court No. 9 of Madrid until 2014 when he joined the firm as counsel. “In Madrid there are a lot of judges that are new and have been promoted in the past two or three years,” Rubio explains. Enrique Grande, partner in the litigation team in Garrigues’ Barcelona office, is another example: he joined the firm from Commercial Court No. 1 in Barcelona.

Aside from greater resources, some want to see greater coordination and cooperation between courts, both within Spain and outside. Carles says it is usually easy to ask the courts for simple things such as requesting a foreign court or insolvency practitioner to answer some questions in writing. “It can take its time as notifications have to be sent abroad, but it works,” he says. “That said, it is nothing like other countries in which, for example, the court in the UK or the US just makes a call to another court in Cayman, or where there are well-defined protocols.”

But what Spain is still missing is a mammoth international test case – something huge like Abengoa entering insolvency, a company with assets all over the world – that would make its communication and cooperation mechanisms evolve.

“I think I would like to see that, to see how it actually works,” Carles said. “The need for collaboration or working together comes when the assets are spread.”

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