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Spanish insolvency reforms: Claims are now more saleable in formal insolvencies

New legislation in Spain now allows claims in an insolvency to be sold with the benefit of voting rights. Iñigo Villoria, Head of the restructuring and insolvency practice in Spain, comments: *"This is a complete turnaround from the legislator's original position. Generally speaking, since 2004 any sale of claims in insolvency left the purchaser without any voting rights in the insolvency process. This has meant that the value in the claims was limited to their face value in a distribution. The new legislation potentially enhances that value, as purchasers are now able to acquire not just the claim, but the voting rights too. This recognises the enhanced value in the trading of those claims and is great news for the Spanish market."*

Legislator has mellowed over time

When the Insolvency Act came into force in September 2004, the legislator was so wary of claims trading in insolvent companies that it expressly prohibited the purchaser from acquiring any voting rights in relation to any arrangements proposed with creditors. This approach was due to claims in temporary receivership proceedings being exploited by debtors, who purchased their own debts cheaply in order to acquire sufficient voting rights to approve an arrangement. The only exception to this was a universal acquisition of assets (inheritance, for natural persons; a merger, spin-off or global assignment, for legal persons) or legal expropriation. In 2011, another exception was included where the purchaser was an entity subject to financial supervision. Now, has been removed entirely. As a result, purchasers who acquire a claim in an insolvent party's estate also get the benefit of any voting rights.

As explained above, this makes the market in trading claims much more attractive to potential purchasers, and opens up the market not just to those who are interested in making a return on any dividends paid out in the insolvency, but also those who may be interested in taking part in the restructuring process.

Voting rights transfer with claims

The reform means that anybody who has the benefit of voting rights will now be able to transfer those rights to any purchaser.

Key issues

- Voting rights now attach to claims traded
- Purchasers of claims in an insolvency can now vote on arrangements with creditors
- Effective from 5 September 2014

In other words, the purchaser is placed in the same position as the original creditor for these purposes. It should be noted that the effect of the reforms is that it does not create any new voting rights, so if the original creditor did not hold any voting rights, nor will the purchaser. This means that for claims which are purchased from a party connected to the debtor, where as a matter of law no voting

rights attach, no voting rights will pass to the purchaser. For connected entities there are different effects to the loss of voting rights, such as subordination, entailing the loss of guarantees (amongst other issues which are beyond the scope of this note).

One hypothesis not foreseen in the law is where the purchaser of a third party's claim is itself connected to the debtor. In this case, doubts arise on the issue of subordination itself, not on the loss of voting rights. Although one may think that subordination is not applicable insofar as the connection did not exist at the time the claim was incurred, the legislation is vague.

In summary, we may conclude that whoever purchases a claim after a declaration of insolvency will not be penalised in any way whatsoever, i.e. the same rights previously held by the assignor will be acquired; no more, no less.

Notification of the transfer

Once a sale and purchase is formalised, the purchaser will step into the shoes of the creditor in the context of the insolvency proceedings. Depending on the current state of proceedings, it will be entitled to exercise the creditor's rights. In order for this to happen, the transfer must be notified to the Receivers. This notification need not follow any formality whatsoever; nor does it amount to an event of rectification of the Creditors' List (when already drawn up – this would only apply if there was an issue relating to the existence or amount of the claim). A change of owner is a simpler matter. The assignment is notified for payment purposes, as otherwise it would not have the releasing effect. For civil law purposes, the assignment is made by the new creditor and is notified to the original debtor. However, in light of the insolvency, it would be logical to also inform the Receivers. From a practical perspective, a joint notification sent by both debtor and creditor would clear up any doubt on the matter.

The assignment of secured claims raises additional difficulties. The parties may wish to avoid notarial and registration costs (and accrual of taxes) which may lead them to execute a notarial agreement, which is not recorded at the Registry. In such case, the new creditor will be in a difficult situation, both in terms of registration and insolvency. In fact, until the transfer is registered, the guarantee cannot be enforced by the purchaser (who is not the mortgage holder) or the vendor (who is no longer a creditor and, consequently, without standing for enforcement purposes; nor is it able to certify the outstanding balance).

The foregoing does not prevent the execution of "silent" assignments or other agreements entailing the transfer of an economic interest. But it is in fact relevant for the party that formally holds creditor status, as it continues to exercise its rights in the insolvency and, ultimately, may receive its debt. Obviously, these "inter-party" agreements may not be upheld vis-à-vis the insolvency and, consequently, may raise issues in the event of a dispute.

Creditor cram down - majorities required for arrangements with creditors

One of the issues to be taken into account by a purchaser is the prominent role it may enjoy when the debtor proposes an arrangement, if any. The strength of its bargaining position will depend upon its relative voting power. This will depend upon a number of different factors relating to the extent of the debtor's liabilities and the different creditor priorities that may apply to those liabilities. This may not be easy to work out at the time of the purchase, but will be an important factor in the pricing of the claims. This will be especially so for significant claims which carry valuable voting rights. For example, these may enable a creditor to impose an arrangement on a minority, for instance under the new regimes for refinancing agreements. It should be noted that under the new refinancing regimes, even secured creditors may be crammed down if the appropriate voting majorities are achieved. So, for example, if a debt reduction is applied, 80% of creditors' claims is required to vote in favour of the debt reduction.

Effective date

In general, the new legislation in relation to voting applies from 5 September where the Receivers have not drawn up a Report (filed between two and three months after the declaration of insolvency). If the Report has already been filed (i.e. the Creditors' List has already been drawn up), the former regime will apply to a subsequent assignment, in such a way that the creditor has no voting rights at the Meeting. This means that, in most insolvencies that are currently underway (i.e. commenced before 5 September), the voting rights will not transfer. For insolvencies commenced after this date, and for those commenced before that date but where the Report has not been drawn up, claims that are assigned will benefit from the transfer of any voting rights attaching to those claims. This change will put Spain on a par with other jurisdictions which already allow the voting rights to transfer.

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