WHAT TO WATCH OUT FOR IN THE SPANISH RESTRUCTURING AND FINANCIAL LITIGATION MARKET IN 2022

In these early days of 2022, we take a look at the trending topics in insolvency and financial litigation that will transform these practices over the next 12 months.

At the legislative and judicial level, 2021 was another year marked by COVID. The measures adopted in Spain since the start of the pandemic have held Spain's business sector in stasis.

Companies facing financial difficulties have benefited from a moratorium that has allowed them to delay taking measures such as declaring insolvency or going into liquidation and, in many cases, they have taken direct or indirect public aid, which has helped them survive these trying times.

These measures, which other European countries have also adopted, have allowed many businesses to remain viable. In addition to unprecedented public debt (which sooner or later will have be paid for by companies and citizens, with the resulting market impact), this has enabled the survival of zombie companies that were already unviable before COVID and have burned through public funds, despite being doomed to insolvency.

These companies will be the first to fall when the financial and legal doping that has been extended again and again in order to delay the inevitable finally comes to an end. But they won't be the only ones; some companies that were viable before the pandemic will not be able to bear the consequences of the successive waves of COVID and will also be pulled under.

Aware of this, the legislature is attempting to breathe new life into insolvency prevention instruments, which are now called restructuring plans and have had a positive impact to date, though generally limited to large companies.

The majority of studies rule out a serious recession in Spain in the short term. Rather, they point to a gradual thinning of the business sector, which is part of the dynamics of the market economy and should not be postponed any longer, to avoid it having an even greater impact.

This change in trend is expected in mid 2022, coinciding with the end of the insolvency moratorium, and will herald a new phase in which we will see more insolvency proceedings – how they end being another matter – and an increase in debt restructuring procedures, which should also help smaller companies.

Key points

Developments in insolvency and financial litigation in 2022:

- The end of the insolvency moratorium
- Reform of the Insolvency Act
- The transposition of the Directive for servicers and purchasers of NPL portfolios
- ICO-backed loans
- CJEU and Supreme Court case law on banking litigation

The effects of the measures put in place to contain the solvency problems of businesses affected by the pandemic will also end in 2022. The first non-payments in financings backed by Spain's Official Credit Institute (*Instituto de Crédito Oficial*, ICO) will also occur.

In the post-COVID era, the EU's stated objective to create a European-level secondary market for non-performing loans (NPLs) may make more sense than ever. EU legislation has set out the bases for regulating the activity of the major players in this market (services and portfolio acquirers).

Lastly, there are matters relating to banking litigation that have yet be decided on by the courts, which should be clarified this year.

All these matters should be paid careful attention during 2022.

1. THE END OF THE INSOLVENCY MORATORIUM

Spanish Royal Decree-Law 8/2020, of 17 March, introduced an insolvency moratorium for the first time in Spanish law, as a response to the solvency difficulties that the outbreak of the pandemic and the measures to contain the spread of COVID were creating in the business world.

While this measure has been in force, the debtor's duty to file for insolvency (within two months of the start of insolvency) has remained suspended, and the processing of applications for insolvency filed by creditors has been forbidden.

The moratorium, which was put in place during the state of emergency, has been extended on multiple occasions in the almost two years since it came into force. Royal Decree-Law 27/2021, of 23 November, extending certain measures to support the recovery, established the last extension (for now), to 30 June 2022.

As companies facing difficulties reach the end of their liquidity, refinancings and insolvency proceedings will increase, in spite of the moratorium. In any case, we will have to wait until the second half of 2022 to see the effects of lifting this measure.

The insolvency moratorium does not mean that directors of companies in difficulties cannot or should not file for insolvency. The fact that, until 2022, insolvency is not attributed to negligence by the directors when the debtor has been insolvent for more than two months does not mean that directors cannot respond to worsening insolvency, if, aware that the situation is irreversible, they do not do anything (in a seriously negligent manner) to harm the company and its creditors.

2. REFORM OF THE INSOLVENCY ACT

On 21 December 2021 the Council of Ministers submitted the bill to reform the Spanish Insolvency Act to the Spanish parliament, the purpose of which is to transpose Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks into Spanish law.

The bill reinforces pre-insolvency instruments, strengthening the mechanisms by which viable companies can avoid insolvency.

The goal is to provide the option to use pre-insolvency mechanisms earlier in cases of a "likelihood of insolvency", a concept which covers the period preceding imminent insolvency. The bill also reinforces the stage for

negotiating with creditors, increasing the effects of filing a letter at court giving notice of the start of negotiations with creditors, not only in relation to credits but also to the agreements to which the debtor is party, and also allows for the time frame for this stage (until now four months) to be extended by a further three months.

The scope of debt restructuring plans is also extended, making the cram-down, not only of dissenting creditors, but also of shareholders (against their will) possible when their stake is verified to have no value due to the existing debt.

The government anticipates that the reform of the Insolvency Act will enter into force by July 2022.

3. THE TRANSPOSITION OF THE DIRECTIVE ON SERVICERS AND PURCHASERS OF NPL PORTFOLIOS

On 8 December 2021 the OJEU published Directive (EU) 2021/2167, of 24 November 2021, which establishes the basis for Member States to regulate the activity of the two main actors in the NPL market: servicers and portfolio purchasers.

The main objective of the Directive is to facilitate the transfer of NPLs by creating a secondary market on a European level. The legislator is seeking to combine this aim with strengthening protection for borrowers' rights.

With regard to servicers, the Directive imposes the need to operate under an authorisation granted by the Member State of origin, which will be recognised by the Member States in which it is to operate. These authorisations must be granted by 29 June 2024. Moreover, it establishes a regime to supervise their activity and a system of sanctions to punish non-compliance.

The regulation of minimums established in the Directive to obtain the authorisation already requires an in-depth review of servicers' compliance programmes. Moreover, taking into account the legal requirements established in the Directive, we will go from talking about purely criminal compliance to discussing more ambitious programmes that also cover civil (banking, consumer affairs and contract), financial and data protection aspects, and that can be adapted to the requirements of national law in different jurisdictions.

As for portfolio purchasers, the idea is to improve their access to information at the pre-contractual due diligence stage. In order to do so, the information on each NPL is standardised and systemised. According to the text of the Directive, this standardisation of information will affect at least those credits that have become non-performing since 28 December 2021. Consequently, credit sellers (financial institutions or holders of portfolios) will have to develop improvements in their credit information processing systems, in order to ensure they meet the reporting obligations for failed positions.

Moreover, portfolio purchasers that are not domiciled in a Member State will have to designate a representative in a Member State, who will be responsible for fulfilling the obligations imposed by the Directive.

The Directive establishes that Member States have to transpose these rules no later than December 2023. Even though the time horizon for fulfilment of the obligations is ample, account should be taken of the significant amount of work involved.

4. ICO-BACKED LOANS

Royal Decree-Law 8/2020, of 17 March, established a package of extraordinary measures to resolve the solvency problems that the pandemic caused for certain businesses. The implementation of these rules was completed by Royal Decree-Law 5/2021, of 12 March, and the Resolution from the Council of Ministers dated 11 May 2021, which approved the Best Practice Code, to which most of the financial institutions operating in Spain signed up.

Among other measures, these texts recognise direct aid and a line of guarantees managed by the ICO in order to partially secure the financing granted by financial institutions to companies and self-employed persons who meet certain conditions.

Moreover, the entities who have signed up to the Best Practice Code must, at the request of their customers and when certain requirements are met, (i) extend the maturity of ICO-backed transactions, (ii) convert ICO-backed loans into participating loans or (iii) negotiate releases to reduce the applicant's debt (guaranteed or otherwise) accrued since 17 March 2020.

In November 2021 the Council of Ministers extended the term for companies and self-employed persons to apply for ICO guarantees and to take advantage of the measures set out in the Best Practice Code to 1 June 2022.[1]

As companies' liquidity runs out, which will largely be conditioned by the expiry of the grace periods, the restructuring of this debt and the lawsuits derived from non-payment will start.

We will have to wait and see how the administration reacts, in terms of the negotiation of credits and the corresponding claims before the courts. In Spanish law, guarantors have to consent to a potential novation of the debt between a debtor and a creditor, and the ICO has consistently demanded that any novation signed by a financial institution that has signed up to the Best Practice Code treat the debtor in at least the same terms as the creditors who are refinancing their debt.

5. CJEU AND SUPREME COURT CASE LAW ON BANKING LITIGATION

In the course of 2022, several outstanding issues in the area of consumer financial litigation will have to be resolved, some of which are of major practical significance:

- The application of **the expiry regime for recovery actions** for amounts paid under abusive clauses, pending a decision from the CJEU: https://www.cliffordchance.com/briefings/2021/10/nulidad-de-clausulas-abusivas---el-reembolso-al-consumidor--a-ex.html
- The limits for declaring **the abusive nature of a clause linking loan interest to the IRPH index**, pending a final decision from the First Chamber of the Supreme Court: https://www.cliffordchance.com/briefings/2021/11/irph---a-la--segunda--va-la-vencida--el-tjue-confirma-que-no-cab.html

1 Resolution dated 30 November 2021, from the Secretary of State for the Economy and Support for Business.

- The possibilities for analysis in terms of the **transparency and the abusive nature of the clause regulating the arrangement fee**, also pending a CJEU decision.

Although we will not be going into the first two issues, having addressed them in past Client Briefings, we do want to draw attention, with regard to the IRPH, to a recent judgment from A Coruña Court of First Instance no. 7, of 29 November 2021, which declared the nullity of an IRPH-linked interest rate clause due to infringement of mandatory rules, specifically for infringing the Ministerial Order of 5 May 1994, on transparency in financial terms and conditions for mortgage loans. A similar position was adopted by Pamplona Court of First Instance no. 7 bis in a judgment on 9 December 2021. As such, there is now an alternative route to nullity due to the abusive nature of a clause.

With regard to the clause that regulates the arrangement fee, in a ruling dated 10 September 2021, the Supreme Court submitted a request for a preliminary ruling to the CJEU, asking for a decision on the extent to which Directive 93/13/EC was in line with the case law of the First Chamber on this subject matter.

It is worth remembering that the Supreme Court considers (i) that the clause in question cannot be analysed in terms of abusiveness if it is transparent (that is, if it is drafted in a clear and understandable manner), as it is an essential element of the agreement and (ii) that the clause does not generate a significant imbalance between the rights and obligations of the parties (see judgment of the plenary bench of 23 January 2019).

This is not the first time the CJEU has addressed this kind of clause. The CJEU judgment of 16 July 2020 resolved the matter in a manner that clashed head-on with the case law of the First Chamber. However, the Supreme Court considers that, on that occasion, the CJEU was conditioned by a distorted approach on the part of the original court in the way it referred the request for a preliminary ruling.

We will have to wait and see if the CJEU maintains its current position or moves in line with the approach of the Supreme Court.

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