THE ART OF THE PRE-PACK

THIRD EDITION

Editors
Jacqueline Ingram and Damilola Odetola

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Publisher's Note

Global Restructuring Review is delighted to publish this new edition of *The Art of the Pre-Pack*, one of our most popular technical guides.

GRR prides itself on being the home for professionals who work in cross-border restructuring and insolvency. We tell them everything they need to know about all that matters. As such, we tend to notice gaps in the literature first: topics that should be covered in detail but haven't been. A few years ago, we realised that 'pre-packs' – private negotiations followed by (the briefest) formal insolvency to cement the deal – are one such area. While the idea is universal, the details vary greatly according to location.

This volume aims to fill that gap, in a pleasingly simple way. It looks past the superficial differences to the underlying common traits. As with so much in this field of professional practice, pre-packs are often a case of the market finding a solution to a problem that nothing else on offer quite solves. In that sense, pre-packs have a certain evolutionary beauty. They're also ephemeral: remove the flaws that make them necessary and they may cease to occur.

But for as long as they are a feature of life, this book will help you master them.

We are grateful to the wisdom of the eminent practitioners who have distilled the art of the pre-pack for us, and we welcome your comments and feedback.

If you enjoy this book, you may be interested in its sister, *The Art of the Ad Hoc*, which is also available on the GRR site and in print. Please write to us at insight@globalrestructuringreview.com for more information.

Last, my personal thanks to the team at Milbank, as editors of this guide, for their vision, and to my colleagues, particularly on the production side, for the elan with which they have brought it to life.

David Samuels
London
April 2023

CHAPTER 7

Spain

Ignacio Buil Aldana, Roma Bastús Vilanova and
Marta Vidiella Sagalés[1]

Introduction

The Spanish insolvency regime has undergone major recent changes that aim to build a framework that facilitates out-of-court restructuring to secure the viability of distressed debtors and provide for an expedited route to facilitate the emergence of insolvent companies.

Since the covid-19 pandemic, the Spanish Insolvency Act (SIA) has been amended on two occasions.

- In May 2020, the Spanish government approved the recast SIA, which attempted to harmonise, clarify and refine Spanish insolvency regulation. This increased the number of articles within the SIA from 242 to 755.
- In September 2022, an amendment to the recast SIA entered into force. This amendment implemented the provisions of the EU Directive on Restructuring and Insolvency,[2] and has strengthened pre-petition restructuring tools, making them more flexible and efficient, and expedited insolvency proceedings.

The amended SIA provides agents involved in restructuring with several tools to tackle insolvency at an early stage, which enables them to avoid lengthy,

1 Ignacio Buil Aldana is a partner, and Roma Bastús Vilanova and Marta Vidiella Sagalés are principal associates, at Cuatrecasas.

2 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

value-eroding insolvency proceedings. The SIA now provides two new tools that allow the implementation of pre-packs sales: a prepackaged sale within a restructuring plan; and the possibility to implement a pre-pack sale.

This chapter provides an overview of the key restructuring tools, highlighting the most relevant amendments to the SIA, and analyses the alternatives for implementing a pre-pack sale within the new regime, assessing whether these new tools will be used in practice.

Overview of key pre-insolvency restructuring tools

Pre-petition notice

Debtors can secure a grace period to tackle insolvency out of court if they serve a judicial notice stating that they are engaged in negotiations to reach a restructuring plan. Only the debtor has standing to serve the notice.

The 2022 amendments to the SIA have strengthened the powers of a pre-petition notice, including by crystallising certain debtor protections, which previously only applied within formal insolvency proceedings (e.g., a ban on *ipso facto* clauses), and by providing the ability to extend the notice's effects to up to six months. Filing a pre-petition notice has the following effects:

- it stays the director's duty to file for insolvency or to wind-up the company (where applicable);
- it stays petitions for mandatory insolvency filed by creditors. Creditors cannot file for insolvency within three months of the notice being filed (and voluntary filings by the debtor have priority over involuntary filings within the fourth month); and
- it stays enforcement action for three months (with limited exceptions for public claims) if the collateral is necessary to continue the ordinary course of business.

The notice can also shield the debtor's assets to the extent necessary for the restructuring plan negotiations, and can shield guarantees or security granted by other group companies to the extent necessary to avoid their insolvency. However, creditors with security interests subject to the special regime on financial collateral and over collateral located outside Spain escape the automatic stay.[3]

Beyond the (limited) automatic stay, no other effect tied to an insolvency proceeding occurs upon the pre-petition notice being issued. In particular, the notice per se has no legal impact on: (1) the ordinary course of business; (2) the

3 Article 8 of Regulation (EU) 2015/848, or relevant treaties where applicable.

management (directors' abilities are not limited, nor is there an officer appointed by the court); or (3) the agreements, guarantees or security granted by the debtor (which cannot be affected by the filing, as *ipso facto* clauses tied to the filing of the pre-petition are banned).

Significantly, the SIA has introduced new provisions relating to executory agreements. While the effects of the pre-petition notice are in force, counterparties may not terminate executory agreements that are necessary for the ordinary course of business, even if grounded on breaches that occurred before the filing of the notice (e.g., a payment breach).

The above effects last for three months. However, the new regime allows debtors to request an extension of the effects of the pre-petition notice for three additional months as long as the request is filed with the consent of at least 50 per cent of the creditors that could be affected by a restructuring plan. The debtor has an additional month to submit a voluntary filing (which would take priority over involuntary petitions during this period).

Restructuring plan and court sanctioning

The key restructuring tool available to debtors (and creditors) is the restructuring plan, which is an out-of-court agreement aimed at restructuring the debtor's assets or liabilities, or both.

This is perhaps one of the key changes introduced to the SIA. As opposed to the former regime of 'refinancing agreements' (strictly limited to the restructuring of financial liabilities), the scope of restructuring plans has been significantly broadened. Restructuring plans can now affect both the liabilities and assets of the debtor.

- Restructuring plans enable a debtor company to compromise almost all its liabilities (with some limited exceptions, such as labour or tort claims). Restructuring plans can therefore affect, inter alia, commercial and financial claims (contingent or not), public claims and top-level management claims.
- Restructuring plans can also compromise the assets of the debtor. The scope of the plan can envisage the sale of assets and business units to third parties.

The SIA has also introduced two new critical elements in the restructuring process.

- The debtor and its creditors can request the appointment of a restructuring expert. Under certain scenarios (e.g., if cramdown effects are sought over a dissenting class of creditors), the appointment of the restructuring expert is mandatory. The main role of the restructuring expert is to monitor the restructuring negotiations and, in certain scenarios, draft certain reports (e.g., valuation of the debtor as a going concern).

- The SIA has also changed how restructuring plans are approved. As opposed to the former regime (which did not formally contemplate cross-class cramdown and consisted of a global vote of the financial creditors' class), restructuring plans are now voted on by classes of creditors, which must be formed based on the existence of a common interest and in accordance with certain rules set forth under the SIA. Once creditors are distributed in different classes, restructuring plans are voted on under the double majority rule. First, creditors within each class must accept or reject the restructuring plan. A plan is deemed approved by a class if two-thirds of the creditors within that class accepts it (the threshold is increased to three-quarters if the class is secured). Second, once all classes have voted, the global majorities come into play. A plan can be approved by all classes (consensual plan) or, if this is not achieved, the plan will be deemed approved when supported by: (1) a simple majority of classes (if a privileged class votes in favour); or, in the absence of this majority, (2) an 'in-the-money' class (to the extent its 'in-the-money' nature is supported by a report issued by the restructuring expert appraising the debtor on a going-concern basis).

The SIA has also broadened the debtor's ability to secure a restructuring plan to avoid insolvency. Debtors can secure a restructuring plan within a current or imminent insolvency situation, as well as in relation to 'likelihood of insolvency'. This concept, added to the SIA in September 2022, is defined as a situation in which the debtor will likely become insolvent within a two-year period unless a restructuring plan is reached. The aim of this is to provide extra time for restructuring plan negotiations.

However, one of the amendments of greatest impact in the recast SIA is the creditor's ability to impose a restructuring plan on the debtor. For current or imminent insolvencies (but not in the event of likelihood of insolvency), creditors can cramdown the debtor and its shareholders, meaning that creditors can impose the terms of the restructuring plan, which can include capitalisation of claims diluting (or even expelling) the current shareholders. Among other things, this amendment aims to prevent subordinated parties (which may be 'out-of-the-money') from 'hijacking' the restructuring negotiations. In turn, shareholders are granted the ability to challenge the court approval of a restructuring plan based on certain limited grounds (e.g., failure to meet the reverse rule). Therefore, in the event of imminent or actual insolvency, debtors (and shareholders) have lost their exclusive right to decide how to address financial distress and can be forced into a plan by creditors.

Restructuring plans need to be court sanctioned. This sanctioning is required to: (1) cramdown holdouts (creditors or shareholders); (2) obtain protection from potential future claw-back actions; and (3) protect new and interim financing granted in the context of the restructuring plan. The amended SIA has also introduced procedural changes to the sanctioning process. Debtors may now decide whether to opt for:

- an *ex ante* challenge process, where holdouts may challenge the approval petition before the sanctioning court rules on the approval of the plan (with a final and non-challengeable ruling); or
- an *ex post* challenge process, where the filing of challenges is brought before the High Court once the sanctioning court has ruled on the plan.

Pre-pack sales

The September 2022 amendments to the SIA introduced the ability to conduct pre-pack sales in Spain. The SIA devotes only five articles (Articles 224 *ter* to 224 *septies*) to this subject. Prior to insolvency declaration, a debtor may request that the competent court appoints an independent expert to gather third-party offers for its business, even if the debtor has ceased activity.

The independent expert may not interfere in the debtor's management, and their appointment does not release the debtor from its obligation to file for insolvency within the legal term.

The SIA also sets out the following prerequisites for offers:

1. the offer must be binding;
2. the offeror must be a third party;
3. payment must be made in cash; and
4. the offeror must commit to either restart the business activity within two years or maintain the business activity for at least two years.

Failure to comply with point (4) would allow stakeholders to claim damages (which must be properly evidenced).

Despite there being definitive progress on pre-pack regulation in Spain, it remains insufficient as it has failed to consider most of the progress made by the Spanish commercial courts (the commercial courts of Barcelona approved a guideline on pre-pack acquisitions that lays out all the steps for the implementation of a pre-pack sale (including transparency rules and the content required for independent expert reports)). Although the appointment of an independent expert grants transparency and publicity to the research of offers, practitioners

dispute its practical application as the length of insolvency proceedings has not been reduced in comparison with the standard regime whereby debtors file an offer at the same time as the insolvency petition.

Overview of key insolvency restructuring tools

It has been proven that the majority of Spanish insolvency proceedings end in liquidation. Accordingly, the latest amendments to the SIA have been aimed at reducing the length of insolvency proceedings, both by amending the composition agreement and by implementing quicker liquidation processes.

Composition agreement

The SIA, as amended on September 2022, has removed the possibility of submitting a pre-arranged composition agreement along with the insolvency petition.[4] Instead, the SIA now sets out a more expedited procedure to approve a composition agreement. The debtor is now able to file all attachments to the composition agreement along with the agreement and end the adherence period,[5] and the in-court creditors' meeting has been replaced by written agreement to the composition agreement (by either wet ink or electronic signature).

The content of composition agreements has remained virtually unchanged (i.e., they mandatorily include a write-off of the debt or a moratorium of payment and must be supported by a viability plan and a payments schedule). The insolvency administrator (IA) is still required to assess the agreement's content.

The recast SIA maintains the inability to liquidate all the debtors' assets through composition agreement despite allowing the sale of the debtor's business unit, and it introduces certain new prohibitions regarding the contents of a composition agreement. In addition, the SIA intends to protect public claims. Therefore, composition agreements for public claims may not include:

- any changes to the applicable law;
- a change of debtor (without prejudice to a third-party guarantee) or an amendment to, or extinction of, the debtor's security interest; or
- debt-in-equity conversion to profitable loans or any other instrument with a different rank to the original claim.

4 Previously also known as 'early composition agreements'.

5 This is the term granted to ordinary and privileged creditors to vote in favour of the composition agreement.

In addition, the SIA introduces new grounds to oppose the approval of a composition agreement: the 'best interest test'. Creditors may now oppose the approval of the composition agreement if they can prove that they would achieve a better financial return from liquidation.

Another aim of the recast SIA was to reduce the time taken for approval of composition agreements. To achieve this, the common phase period (which precedes the potential composition agreement phase) has been reduced. The IA must file its provisional report along with a list of claims and the debtor's list of assets within two months of its appointment. Once this report is filed, the common phase will conclude and the composition phase will be commenced within 15 days, regardless of potential challenges to the report (which historically delayed the initiation of the composition phase).

Liquidation

The major amendment to the liquidation phase has been the removal of liquidation plans, which promoted business unit sales within the liquidation phase.

Under the previous regime, a sale of the business unit could be conducted at three different stages during the insolvency proceeding. At the earliest stage, a binding business unit offer would be filed together with the insolvency petition. Acquirers could also try to acquire unit offers during the common phase and the liquidation phase.

Sales conducted during liquidation are the least attractive option due to potential delays being created by the fact that the ruling approving the liquidation plan is subject to challenge before the higher courts. In most cases, the appeal stayed the approval of the liquidation plan and, consequently, the sale of the business unit. These delays could be 12 to 18 months and hence be highly destructive to the value of the business unit.

Can a restructuring be implemented on a prepackaged basis?

The SIA now envisages two ways of implementing pre-pack sales:

- the pre-pack sale process: this sale of the business unit is generally conducted during one of the pre-insolvency stages (e.g., market prospect analysis, due diligence process or selection of winning offer stage) but approved during an early stage of the insolvency procedure because formal insolvency filing is required; or
- a prepackaged restructuring plan: the sale of the business unit is envisaged as part of a restructuring plan, at a pre-insolvency stage. Approval of the restructuring plan (and the pre-pack sale envisaged therein) is executed through a court sanctioning process and hence avoids formal insolvency filing.

Analysis of pre-pack sales

The sale of business units is conducted in accordance with Articles 215 to 225 of the SIA. These regulations apply regardless of the stage at which the sale is conducted during insolvency proceedings (whether during the common phase or liquidation). Prior insolvency filing would be required as the insolvency court would have to approve the pre-pack sale.

The appointed independent expert's key functions are to monitor the gathering of third-party offers, ensure transparency of the business sale and file a report on the offer. Once the final offer – with these prerequisites – is submitted, the debtor petitions for insolvency at the same time and the court[6] opens the insolvency proceeding, ratifying (or not) the independent expert as insolvency administrator.

Articles 215 to 225 of the SIA set the framework for the sale of the debtor's business unit within the insolvency proceeding, which provides the following protections, among others:

1. existing agreements: the acquirer will automatically assume the debtor's position in all current agreements linked to the business unit; the counterparty does not have the right to challenge that assumption;
2. public licences: all licences required to continue the business activity will be automatically transferred by means of the sale of the business unit; and
3. liabilities: the acquirer may cherry-pick which liabilities they will assume. Otherwise, the liabilities of the debtor (both pre-insolvency and claims against the estate) will not be transferred to the acquirer of the business unit.

Point (3) does not apply when the acquirer of the business unit is a special related party to the debtor[7] and when the employees are transferred along with the assets, as this is considered a 'business succession' for labour and social security purposes,[8]

6 The court that appointed the independent expert retains jurisdiction to declare the debtor insolvency.

7 Where the debtor is a corporation, these persons are: (1) any shareholder holding at least 10 per cent of capital stock (5 per cent in the case of listed companies), unless the claim had accrued prior to the acquisition of the shares (only for financial claims); (2) directors (including de facto and shadow directors) and general managers (for any claims irrespective of the accrual's date); (3) companies belonging to the debtor's group of companies and any common shareholders, unless the claim accrued prior to the acquisition of the shares; and (4) assignees of any of the aforesaid claims within two years prior to the insolvency declaration. These creditors are deprived of their security interests.

8 Spanish Insolvency Act, Article 221.

and carries liability for these obligations. Article 224 of the SIA sets forth that if human resources are transferred along with the assets, the acquirer will assume all unpaid liabilities, excluding the parts covered by the Salary Guarantee Fund.

The SIA has introduced relevant amendments to the labour and social security succession regime. Commercial courts shall have sole jurisdiction to declare the existence of the succession, as well as to determine the assets, liabilities and employment relationships of which it is composed.[9] However, this case law will have to be followed closely.

Article 225 of the SIA sets forth that the ruling authorising the sale of the business unit to the seller will assign the assets free and clear from any previous liens and encumbrances, unless the acquirer wishes to maintain those liens or encumbrances over the assets. If the business unit includes secured assets, the applicable regime varies depending on whether the security interests are kept in place following the sale of the business unit.

If kept in place, the transfer of the encumbered asset will not require the creditors' consent.

If the assets are transferred 'free and clear', the SIA differentiates between cases in which the purchase price is equal to or higher than the value of the security interest and cases where it is lower. In the first case, the special privilege creditors' consent is not required. On the contrary, if the purchase price is lower than the value of the security interest, the release of the security interests will require the consent of those special privilege creditors who have a separate right to enforce the assets' in rem security and who represent at least 75 per cent of the special privilege claims. If both requirements are not met (i.e., separate right to enforce and majority of 75 per cent), the consent of the secured creditor will not be required.

Upon receipt of the IA's and employees' report on the offers submitted and the allegations by the parties, as the case may be, the court will issue a ruling awarding the business unit to the offeror.

Analysis of prepackaged restructuring plans

A pre-pack sale can also be envisaged within a restructuring plan. This possibility was introduced to the SIA following its amendment in September 2022.

9 Historically, there has been a dispute between the labour courts and the commercial courts as to which courts had jurisdiction to determine the effects of the 'business succession' for labour and social security purposes.

Because restructuring plans can affect both assets and liabilities of the debtor, a prepackaged business unit sale could be envisaged in a restructuring plan. This would work as an alternative to a business unit sale (prepackaged or not). Although the prepackaged restructuring plan would still be subject to court sanctioning, it would avoid filing for a full-blown insolvency proceeding.

However, although this is a possibility on paper, there are certain deficiencies in the SIA that may hinder the application of prepackaged restructurings in practice. The main issue is that the sanctioning court might not be able to grant all the protections that business unit sales have within formal insolvency proceedings.

Because business unit sales can only be approved within a formal insolvency proceeding (even if pre-packed), the provisions governing sales of business units as detailed above apply only in the event of a formal insolvency proceeding (First Book of the SIA). However, restructuring plans are governed by the SIA provisions applicable to pre-insolvency measures (Second Book of the SIA). This means that the business unit sale provisions that apply to insolvency proceedings might not be applicable at the pre-insolvency stage. On this basis, there are grounds for believing that the sanctioning court might not be allowed to apply the business unit sale protections to prepackaged restructuring plans. This argument would also be reinforced with the limited control that the sanctioning court has over the debtor and the restructuring plan (the court intervention should be limited to verifying whether the restructuring plan meets all legal requirements or, potentially, to analysing potential challenges to the plan).

The potential inability to bring the business unit protections to pre-insolvency stages (and hence conducting a pre-pack sale within a restructuring plan) has the following risks, which may well hinder the practical application of prepackaged restructuring plans.

- The inability to cherry-pick liabilities: as detailed above, business unit sales allow debtors to exclude most of their liabilities from the transaction. Restructuring plans do not grant effective tools for creditors to cherry-pick liabilities and do not specify how liabilities are treated in a prepackaged restructuring plan. There is therefore a risk that some (or all) of the liabilities would 'travel' with the business unit. As a potential remedy, the restructuring plan could provide for the prior restructuring of liabilities, but it might not allow for a 100 per cent haircut to all liabilities, which is essentially how liabilities are treated in business unit sales.
- 'Business succession' for labour and social security purposes: as opposed to the insolvency regime, prepackaged restructuring plans may not benefit from labour and social security protections. Therefore, if only some of the employees of the debtor (i.e., not the entire workforce) transferred, the acquirer may still

be liable for any outstanding debts to remaining employees (or even be forced to hire the entire workforce in the new structure, maintaining their seniority and wages).

- Prepackaged restructuring plans must ensure the viability of the debtor. However, a prepackaged restructuring plan would potentially involve the transfer of most of the debtor's assets to a new entity, while leaving most of the liabilities with the debtor. In this scenario, even if the restructuring plan would ensure the viability of the transferred business unit, it might not ensure viability of the debtor. This could potentially be used as grounds for challenging the restructuring plan.

The above risks may well thwart prepackaged restructuring plans. We are not aware of any prepackaged restructuring plans that have been used in Spain to date.

As a *de lege ferenda* proposal, the SIA should harmonise the provisions that apply to business unit sales (First Book of the SIA) with those that apply during the pre-insolvency stage (Second Book of the SIA). This would involve bringing all the business unit sale protections to the pre-insolvency stage, granting the appropriate protections to the relevant parties. Inter alia, these protections could ensure that: (1) the sale of the business unit is carried out on market terms (and monitored by the restructuring expert); and (2) certain (or all) the liabilities are left with the debtors (i.e., not transferred to the new entity) to ensure the viability of the business unit (and not the debtor).

If there is no true 'pre-pack', can the aims be achieved by other means?

The SIA does allow pre-pack sales, although their regulation should be amended to make the process more efficient.

Under the current regime, acquirers wishing to merely conduct an asset-led business unit deal have no alternatives other than to conduct a pre-pack sale or a regular business unit sale at an early stage of the insolvency proceeding.

To the extent the SIA has not been amended to allow the application of the rules governing business unit sales within an insolvency proceeding to prepackaged restructuring plans, acquirers willing to conduct business unit sales that require refinancing of the liabilities (e.g., key suppliers' debt or secured liabilities) may be able to conduct a two-step restructuring pre-pack sale, which would entail: (1) acquiring the business unit within an insolvency proceeding; and (2) restructuring the assumed liabilities in the new structure on pre-agreed terms once the business unit sale has concluded. This would ultimately work as an alternative to pre-pack sales envisaged within restructuring plans.

Case studies

In addition to the recent amendments to the SIA, the law only provides a limited choice of tools for implementing a pre-pack solution. More time is required to test the practical application of the recast SIA.

Conclusion

Is a pre-pack possible in Spain?

The SIA formally provides for the implementation of pre-pack sales, which can be achieved within a formal pre-pack sale (approved within an insolvency proceeding) or through a restructuring plan envisaging a pre-pack sale (approved within a court sanctioning proceeding). However, the current regime should be amended to grant more effective tools to restructuring agents and to ease and promote the pre-pack sales process. Namely, the regime should allow parties to benefit from the business unit sales regulation (i.e., protection) granted to insolvency proceedings during prepackaged restructuring plans.

‘Pre-packs’ remain important in the restructuring world, but how one gets one done varies greatly from place to place. This guide aims to simplify the subject by cutting through the surface elements to the underlying common traits.

The Art of the Pre-Pack draws on the wisdom of 16 pre-eminent practitioners from around the world to distil the essence of a successful pre-pack. It is a companion to Global Restructuring Review's *The Art of the Ad Hoc*, on how to work successfully with ad hoc committees. Find both volumes on www.globalrestructuringreview.com.

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