SPAIN. COVID-19, recent legal reforms and other relevant topics

Madrid, 25 May 2020

Following the declaration of the state of emergency[1] as a result of the COVID-19 crisis the Spanish Government has approved a series of legal provisions excepting certain general rules laid down, in particular, in the Insolvency Act (IA) and the Corporates Act (CA).

This note analyses the most relevant legal reforms and other issues relating to the COVID-19 in the fields of (1) insolvency law, (2) corporate law, (3) civil and commercial law, (4) litigation and (5) foreign investments.

1. Insolvency law

1.1. Filling for insolvency

A. Insolvent debtors are not obliged to file for voluntary insolvency until 31 December 2020[2] and thus, in principle, guilty insolvency should not be declared for late filing. This exceptional rule does not expressly require that the insolvency results from the COVID-19 and applies regardless of whether the debtor has filed an article 5 bis IA notification[3].

Nevertheless, debtors are entitled to file for insolvency before 31 December 2020 and it seems advisable they do so should they consider that the declaration of insolvency is in the best interest of the stakes at hand[4].

In any case, unilateral enforcement of claims by creditors will still be possible in 2020 unless (i) insolvency is declared or (ii) an article 5 bis IA application is made, and this may be another reason for voluntary filing in 2020[5].

B. Applications for compulsory insolvency filed by creditors after the declaration of the state of emergency (14 March 2020) can be made but will not be considered by courts until 31 December 2020, and voluntary insolvency petitions filed by debtors before that date will prevail[6].

This gives debtors the opportunity to negotiate refinancing agreements with all or part of their creditors during 2020, free from the sword of Damocles that a

[1] The state of emergency was declared on 14 March 2020 and, unless a further extension is approved, will end on 7 June 2020.

[2] Article 11.1 of the royal decree-act 16/2020 of 28 April.

[3] A notification by the debtor to the court that it has started negotiations with its creditors to reach a refinancing agreement or an early composition arrangement (*propuesta anticipada de convenio*).

[4] The EU directive 2019/1023 of 20 June 2019 on preventive restructuring frameworks has not been transposed into Spanish law yet, but nonetheless directors would be well advised to take it into account and, in particular, recitals 70 and 71.

[5] However, see 3.2.C below about a recent court decision prohibiting enforcement of certain financial collateral following an *ex parte* injunctive relief sought by a company not having filed for insolvency.

[6] Article 11.2 of the royal decree-act 16/2020 of 28 April.

dissenting creditor files for compulsory insolvency (although unilateral enforcement of claims is still possible, in general, as said above).

1.2. *Fresh money* from *specially related persons* (SRPs)

A. As regards insolvencies judicially declared (not merely requested by the debtor) between the declaration of the state of emergency (14 March 2020) and 14 March 2022, the general IA rule of *equitable subordination* of SRPs' claims[7] will not apply to claims resulting from (i) *fresh money* lent to or injected into a company or (ii) payment of *ordinary* or *privileged claims* on behalf of an insolvent company, provided (i) or (ii) take place after the declaration of the state of emergency (14 March 2020); these claims will be considered *ordinary*[8].

This exceptional provision intends to incentivise SRPs to provide new funds to companies with liquidity problems, as, in addition to avoiding being ranked as *subordinated*, SPRs will be entitled to vote on composition arrangements (*convenios*). However, its results may be limited in practice given that it does not seem possible to secure SRPs' *fresh money* claims with a collateral that is enforceable *vis-à-vis* the insolvency's estate.

B. In case of breach of a composition arrangement approved or amended between the declaration of the state of emergency (14 March 2020) and 14 March 2022, claims resulting from (i) *fresh money* lent to or injected into the insolvent company or (ii) guarantees provided to secure its debts will be considered *estate claims*, even as regards SRPs, as long as (i) or (ii) derive from the original or amended composition arrangement[9].

This exceptional provision may be a real incentive to financially support companies having temporary difficulties to fulfil their composition arrangements where the business or the assets have a material value.

As these rules (A and B) apply to insolvency proceedings judicially declared before 14 March 2022, their practical results will largely depend on how swiftly

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[7] According to the IA the following persons and entities are considered SRPs:

i. Shareholders personally liable for the insolvent company's debts as a matter of law and shareholders holding, directly or indirectly, at the time their claims arose, 10% or more of the share capital of the insolvent company (or 5% or more for listed companies).

   When the shareholder is an individual, the following are also SRPs:

   a. Spouses, registered partners or unmarried cohabitating partners within the two years prior to the declaration of insolvency.
   b. Ascendants, descendants or siblings of the shareholder or of any person referred to in a above.
   c. Spouses of the shareholder's ascendants, descendants or siblings.
   d. Companies controlled by the shareholder or by any person referred to in a to c above and their directors (*de jure* or *de facto*).
   e. Companies belonging to the same group of companies as those referred to in d above.
   f. Companies in which any person referred to in a to e above is a director (*de jure* or *de facto*).

ii. Directors (*de jure* or *de facto*), liquidators and general proxies of the insolvent company within the two years prior to the declaration of insolvency.

iii. Companies belonging to the same group of companies as the insolvent company and their "common shareholders" meeting the requirements of i above.

[8] Article 12 of the royal decree-act 16/2020 of 28 April.

[9] Article 9.3 of the royal decree-act 16/2020 of 28 April.

courts decide insolvency filings (in particular as regards filings made near that date).

1.3. Breach and amendment of composition arrangements (*convenios*)

A. Debtors having reached a composition arrangement with their creditors are entitled to request its amendment not later than 14 March 2021 (regardless of whether they have breached the composition arrangement or not). Creditors are not entitled to such a request. Approval of the proposed amendment will require the general majorities provided for by the IA for the approval of a composition arrangement. Creditors whose claims have arisen after the approval of the original composition arrangement and *privileged creditors* will not be affected by the amendment unless they vote in favour of it or expressly adhere to it[10].

B. Applications for the declaration of breach of a composition arrangement[11] filed by creditors between the declaration of the state of emergency (14 March 2020) and 14 September 2020 can be made but will not be considered by courts until 14 December 2020. Courts will give priority over such applications to the request for amendment of the composition arrangement that the debtor may file before that date[12].

C. Debtors not able to fulfil their obligations pursuant to a composition arrangement or other obligations incurred afterwards are not obliged to file for liquidation until 14 March 2021, provided they request an amendment of the composition arrangement which is admitted by the court before that date[13].

D. Applications for liquidation filed by creditors after the declaration of the state of emergency (14 March 2020) can be made but will not be considered by courts until 14 March 2021[14].

These provisions may afford debtor companies leverage to renegotiate composition arrangements avoiding the liquidation of their assets, provided dissenting *estate* and *privileged claims* are not material.

1.4. Breach and amendment of judicially sanctioned refinancing agreements

A. Debtors with a refinancing agreement judicially sanctioned pursuant to the fourth additional provision of the IA[15], whether before or after the declaration

[10] Article 8.1 of the royal decree-act 16/2020 of 28 April.

[11] The declaration of breach of a composition arrangement gives rise to (i) its termination, (ii) the ineffectiveness of the amendments of the terms of the original claims and (iii) the opening of the liquidation phase and (iv) entitles secured creditors that were bound by the composition arrangement to enforce their security rights.

[12] Article 8.2 of the royal decree-act 16/2020 of 28 April.

[13] Article 9.1 of the royal decree-act 16/2020 of 28 April.

[14] Article 9.2 of the royal decree-act 16/2020 of 28 April.

[15] Refinancing agreements must meet certain statutory requirements to be judicially sanctioned: (i) be part of a viability plan that allows the debtor to continue its business activity in the short and medium term, (ii) significantly increase the amount of available credit or amend or terminate the debtor's

of the state of emergency, are entitled to notify the court, not later than 14 March 2021, that they have started or plan to start negotiations with their creditors to amend the existing refinancing agreement or to reach a new one, even within the first year following the date of the request for sanctioning of the original agreement[16].

B. Applications for the declaration of breach of a judicially sanctioned refinancing agreement[17] filed by creditors between the declaration of the state of emergency (14 March 2020) and 14 September 2020 can be made but will not be considered by courts until 14 October 2020. If, before that date, the debtor notifies the court that it has entered or plans to enter into negotiations with its creditors to amend the existing refinancing agreement or to reach a new one, such creditors' applications will only be considered by the court if the negotiations do not come to a successful end within three months of the date of the debtor's communication[18].

These provisions will afford debtor companies leverage to renegotiate judicially sanctioned refinancing agreements that they are not able to fulfil, giving them some time before creditors can file for compulsory insolvency or enforce their claims.

1.5. The new codified Insolvency Act

On 5 May 2020 the Spanish Government, pursuant to a mandate of the Parliament, approved a codified version of the IA (CIA) that will enter into force on 1 September 2020, except as regards certain provisions.

The CIA is aimed at clarifying and harmonizing the provisions of the IA, following its numerous amendments and, thus, should not involve substantive changes (and to the extent it would, they could be held to have been passed *ultra vires*).

However, the Council of Ministers has announced (i) further reforms aimed at transposing the EU directive 2019/1023 of 20 June 2019 on preventive

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obligations, (iii) be entered into by holders of at least 51% of financial claims (excluding SRPs), as certified by the debtor's auditor, and (iv) be notarized.

As regards syndicated loans, all syndicated lenders will be understood to have entered into the refinancing agreement provided a majority of at least 75% of the syndicated claims agree, unless the syndication agreement requires a lower majority.

Similarly to the schemes of arrangement, judicially sanctioned refinancing agreements bind, with some limitations, dissenting financial creditors, provided that certain majorities of the financial claims are obtained (the majorities range from 60 to 80 per cent, depending on whether the dissenting claims are secured or not and on the terms of the agreement).

Judicially sanctioned refinancing agreements are protected from claw-back actions.

[16] Article 10.1 of the royal decree-act 16/2020 of 28 April.

Pursuant to the IA a debtor cannot request the court to sanction a new refinancing agreement until one year has passed.

[17] Once a breach of a judicially sanctioned refinancing agreement is declared, creditors are entitled to file for compulsory insolvency or enforce their claims.

[18] Article 10.2 of the royal decree-act 16/2020 of 28 April.

restructuring frameworks and (ii) additional exceptional legal provisions to face the COVID-19 crisis.

2. Corporate law[19]

2.1. Compulsory dissolution of a company and directors' liability for corporate debts[20]

A. Directors' obligation to call a GSM within two months of the occurrence of an event of compulsory dissolution of a company is suspended until the end of the state of emergency[21].

B. If an event of compulsory dissolution occurs during the state of emergency, directors will not be liable for company's debts incurred before its end[22].

C. As regards compulsory dissolution due to a net equity drop below fifty per cent of the share capital,

i. losses incurred in financial year 2020 will not be taken into account for calculating the net equity drop and

ii. losses incurred during financial year 2021 will only trigger directors' obligation to call a GSM for it to dissolve the company or remedy the situation within two months from the year end[23].

Losses incurred in 2020 will not trigger directors' obligation to react as regards financial year 2020, but it is unclear whether they must be taken into account as regards subsequent financial years, given the temporary and exceptional nature of this measure.

2.2. Distribution of dividends

Companies having suspended employment contracts or temporarily reduced the working hours of their employees due to *force majeure* relating to the COVID-19 (pursuant to article 22 of the royal decree-act 8/2020 of 17 March) and having benefited from the "public resources" made available to them will not be entitled to distribute dividends out of the profit obtained in the financial year in which such measures have been adopted, unless they pay the Social Security contributions from which they have been exempted. This prohibition

[19] This note does not address certain measures adopted for listed companies.

[20] The general rule under the CA is as follows: Directors are jointly and severally liable for company's debts incurred after the occurrence of an event of compulsory dissolution (e.g. the reduction of the company's net equity below 50% of its share capital as a result of losses) (i) if they fail to call a general shareholders' meeting (GSM) to address the situation within two months from the date when they knew or should have known about the event or, (ii) in case the GSM is not held or it does not pass the appropriate resolutions, if they fail to request the judicial dissolution or the declaration of insolvency of the company, as appropriate, within two months.

[21] Article 40.11 of the royal decree-act 8/2020 of 17 March.

[22] Article 40.12 of the royal decree-act 8/2020 of 17 March.

[23] Article 18.1 of the royal decree-act 16/2020 of 28 April. Nothing is said about companies whose financial year does not end on 31 December.

will not apply to companies that had less than fifty workers on 29 February 2020[24].

2.3. Shareholders' right to exit the company

A. Shareholders are not entitled to exercise their right to exit the company pursuant to the CA or the company's by-laws until the end of the state of emergency[25].

B. As regards the general right to exit the company due to non-distribution of dividends[26], the financial year in which distribution of dividends is prohibited according to 2.2 above will not be taken into account[27].

2.4. Meetings of corporate bodies

A. During the state of emergency, GSMs and meetings of boards of directors and executive committees may be held by video or telephone conference even if not provided for by the company's by-laws, as long as all members have the necessary IT resources[28]. Additionally, meetings of board of directors may be held in writing if the chairman so decides or upon the request of two directors (hence without the need of a unanimous decision of all board members as set out by the CA)[29].

B. GSMs called before the state of emergency can be postponed, held at a different place or cancelled, following certain publication formalities. In case of cancellation, the board of directors will call a new GSM within the month following the end of the state of emergency[30].

2.5. Annual financial statements

A. Directors' obligation to draw the company's annual financial statements within three months of the year end will be suspended until the end of the state of emergency. The three-month period will start counting from the beginning once the state of emergency is lifted. Nevertheless, directors can draw the annual financial statements during the state of emergency should they deem it appropriate[31].

B. In case directors have already drawn the financial statements, they can modify the proposal of allocation of the financial results to adapt it to the new

[24] Article 5.2 of the royal decree-act 18/2020 of 12 May.

[25] Article 40.8 of the royal decree-act 8/2020 of 17 March.

[26] Subject to certain conditions and with a number of exceptions, shareholders have the right to exit the company if the GSM does not agree to distribute at least 25 per cent of legally distributable profit obtained in the preceding financial year, provided the company obtained profits in the last three financial years.

[27] Article 5.2 of the royal decree-act 18/2020 of 12 May.

[28] Article 40.1 of the royal decree-act 8/2020 of 17 March.

[29] Article 40.2 of the royal decree-act 8/2020 of 17 March.

[30] Article 40.6 of the royal decree-act 8/2020 of 17 March.

[31] Article 40.3 of the royal decree-act 8/2020 of 17 March.

circumstances resulting from the COVID-19 crisis provided the modification is justified[32].

C. In any case, the GSM must vote the annual financial statements within six months of the end of the state of emergency[33].

3. Civil and commercial law

3.1. Limitation and time barring periods

Limitation and time barring periods (*plazos de prescripción y caducidad*) of any rights and actions are suspended since 14 March 2020[34].

The suspension will be lifted on 4 June 2020[35].

3.2. *Force majeure, frustration of contract and hardship*

The COVID-19 crisis and the measures recently approved by the Spanish Government as a result are having a great impact on many agreements. There are different legal provisions and principles (*force majeure*, *frustration of contract or rebus sic stantibus*, which is a sort of *hardship*) under which, depending on the circumstances, the affected party may request to terminate the agreement or amend its terms (see A to C below).

However, it must be noted that these legal provisions and doctrines are exceptions to the fundamental principle of *pacta sunt servanda* and, as such, have traditionally been interpreted in a very restrictive way. Therefore, despite the extraordinariness and unprecedentedness of this situation, it is far from clear how courts will view unilateral termination or amendment of agreements (courts' decisions of the ensuing lawsuits will in any case be long). It is highly advisable, thus, to negotiate in good faith during a reasonable period of time before taking any unilateral action that eventually may be found unlawful by a court.

A. ***Force majeure***

Under Spanish law, a debtor is not liable for fulfilling its obligations if prevented from doing so due to *force majeure*, unless otherwise provided for by law or by the agreement[36].

It seems reasonable to claim that the COVID-19 crisis is an event of *force majeure* (in fact, pandemics are paradigmatic examples of *force majeure* according to Spanish case-law and some of the royal decree-acts recently enacted by the Spanish Government emphasize the extraordinariness of the circumstances and expressly refer to *force majeure* in relation to the suspension

[32] Article 40.6 bis of the royal decree-act 8/2020 of 17 March.

[33] Article 40.5 of the royal decree-act 8/2020 of 17 March.

[34] Fourth additional provision of the royal decree 463/2020 of 14 March.

[35] Article 10 of the royal decree 537/2020 of 22 May.

[36] Article 1,105 of the Spanish Civil Code.

of employment contracts and reduction of working hours), but this is not enough for a debtor to be released from its obligations.

The debtor must bring evidence that, in its particular case, a specific circumstance resulting from the pandemic (e.g. a specific measure approved by the Spanish Government) makes it impossible to fulfil its obligations under an agreement, regardless of all reasonable efforts.

Only debtors with non-pecuniary obligations may be released from them due to *force majeure*; debtors that simply owe money cannot, since money is a fungible asset.

B. Frustration of contract

Under Spanish law, one of the essential elements of every agreement is its objective function (*causa*), generally understood as the aim pursued by the parties when entering into the agreement, i.e. the social, economic or business purpose of the agreement.

The *purpose* must remain for the whole term of the agreement and if it ceases to exist or becomes unachievable at some point the affected party will be entitled to terminate the agreement. This doctrine, which has been referred to in several ways (supervenient lack or frustration of the purpose of the agreement or collapse of its business basis), has been very restrictively applied.

C. *Rebus sic stantibus* (a sort of *hardship*)

Rebus sic stantibus is a Supreme Court doctrine that allows to terminate an agreement or to amend its terms in case the circumstances existing when the agreement was entered into change, provided that the change (i) is extraordinary and (ii) unexpected and (iii) makes one party's obligations excessively onerous, giving rise to an exorbitant imbalance between the parties' obligations.

This doctrine has been applied by the Supreme Court in a very restrictive way (only in a very few cases so far) and usually, if not always, to declare the right to amend the terms of an agreement, not no terminate it.

However, two recent court decisions have granted interim measures (one of them *ex parte*) preventing enforcement of certain guarantees on *rebus sic stantibus* grounds:

- In one of them a borrower and its guarantors –belonging to the Spanish leading steel manufacturing group Celsa– submitted that, due to a dramatic drop in sales resulting from the COVID-19 crisis, (i) the borrower was unable to make the amortizing and interest payments due in May and November 2020 and to meet the financial ratios provided for in a syndicated loan agreement entered into in 2017, and (ii) they intended to file a claim requesting the adaptation of the loan agreement to the new circumstances. They further submitted that the likely imminent enforcement of the guarantees by the lenders (and, in particular, the

financial collateral) would lead to the collapse of the business before a judgment on the merits was rendered, to the detriment of the workers and the non-secured creditors.

On that basis, the borrower and guarantors filed an *ex parte* injunction requesting the court (i) to suspend the payment and financial ratios obligations until May and March 2021, respectively, and (ii) to forbid the lenders to early terminate the loan agreement and to enforce the guarantees. The court granted the injunction on 30 April 2020 given that the COVID-19 crisis had unforeseeably and extraordinarily altered the viability plan which had been the basis of the loan agreement.

- According to the press, a court of Zaragoza has granted an injunction ordering Adidas not to enforce certain guarantees given by one of its franchisees, which had submitted that otherwise the viability of its business (seven shops) and the very performance of the franchise agreement would be seriously compromised.

4. Litigation

4.1. Suspension of judicial activities and procedural time limits

Judicial activities and procedural time limits are suspended as from 14 March 2020, with a few exceptions that include any procedural activity aimed at preventing irreparable damages[37]

Despite the suspension, (i) some courts have kept issuing and notifying judgments and other resolutions during the state of emergency (ii) and parties are allowed to file claims and certain submissions before courts.

The suspension will be lifted on 4 June 2020[38] and time limits will start counting from the beginning[39].

4.2. Telematic hearings

During the state of emergency and three months after its end, hearings will be preferably held remotely, provided courts have the necessary IT resources[40].

There is still high uncertainty about the degree and form of implementation of this measure. It will depend on the IT resources available at each court, which currently seem insufficient in most cases. In addition, some have casted doubts as to whether, under certain circumstances, a hearing held remotely may entail a breach of the due process.

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[37] Second additional provision of the royal decree 463/2020 of 14 March and decisions of the General Council of the Judiciary, the Ministry of Justice and the State General Prosecutor.

[38] Article 8 of the royal decree 537/2020 of 22 May.

[39] Article 2.1 of the royal decree-act 16/2020 of 28 April.

Furthermore, time limits to challenge judgments and other final court decisions notified during the estate of emergency or within twenty working days following its end have been extended (article 2.2 of the royal decree-act 16/2020 of 28 April).

[40] Article 19.1 of the royal decree-act 16/2020 of 28 April.

4.3. Exceptional working days

11 to 31 August 2020 will be working days for all judicial proceedings[41].

4.4. Other measures

The General Councils of the Judiciary and of the Spanish Bars have proposed ambitious sets of measures aimed at avoiding the collapse of courts as a result of the COVID-10 crisis. There is great uncertainty as to which of them will be approved.

In any case, it is almost certain that, as in most countries, judicial activity will be materially protracted despite the best efforts that courts have been and will no doubt be making in the months and years ahead.

5. Foreign investments

The general liberalization regime of foreign investments has been suspended as from 18 March 2020 as regards (i) transactions that result in either the acquisition of a 10 per cent or higher stake in a Spanish company or the effective involvement in the management or control of it (ii) by investors resident outside the EU and the EFTA or whose "beneficial owners" are resident outside these territories[42], (iii) provided any of the following requirements is met:

a) The investment is made in certain sectors related to public order, security and health, namely: (i) critical infrastructures, including energy, transport, water, healthcare, communications, media, data processing or storage, aerospace, defence, electoral and financial infrastructures; (ii) critical technologies and dual-use items, including artificial intelligence, robotics, semiconductors, cybersecurity, nanotechnologies, biotechnologies, aerospace, defence and energy storage technologies; (iii) supply of essential inputs, including energy, raw materials and food security; (iv) sectors with access to sensitive information, such as personal data, and (v) media.

b) The foreign investor is directly or indirectly controlled by the government, public bodies or armed forces of another country.

c) The foreign investor has invested or been involved in sectors related to public order, security or health (especially those referred to in a above) in another Member State.

d) Administrative or judicial proceeding have been brought against the foreign investor in another country for criminal or illegal activities.

[41] Article 1.1 of the royal decree-act 16/2020 of 28 April.

[42] Direct or indirect ownership or control of more than 25 per cent of the share capital or voting rights of the investor or direct or indirect control of the investor by any other means will be deemed "beneficial ownership" for these purposes.

These foreign investments are conditioned to the prior authorisation of the Council of Ministers, that has to be issued in six months (failure to issue an express decision means that the investment is not authorised)[43].

As an exception, transactions in which the price was agreed by the parties or determined in a binding offer before 17 March 2020 and transactions amounting to less than €5,000,000 are subject to a simplified procedure of authorisation, while transactions amounting to less €1,000,000 are exempted from authorisation[44].

[43] Fourth final provision of the royal decree-act 8/2020 of 17 March and third final provision of the royal decree-act 11/2020 of 31 March.

[44] Second transitional provision of the royal decree-act 11/2020 of 31 March.