



Spanish Parliament Passes Bill Amending Insolvency Act and Public Sector Contracts Act

On October 1, 2015, the Public Sector Legal Regime Act (*Ley 40/2015, 1 de octubre, de Régimen Jurídico del Sector Público*) (“PSLR Act”) was passed by the Spanish Parliament. As discussed in more detail below, the PSLR Act introduces, among other things, the following reforms to the Spanish Insolvency Act (*Ley 22/2003, de 9 de Julio, Concursal*) (“SIA”) and to the Spanish Public Sector Contracts Act (*Real Decreto Legislativo 3/2011, de 14 de noviembre, por el que se aprueba el texto refundido de la Ley de Contratos del Sector Público*) (“SPSC Act”):

- A clarification of the ranking in insolvency proceedings of debts secured by pledges granted over future credit rights;
- The addition of a provision requiring prior approval by the relevant contracting authority for the granting of pledges over credit rights arising from the liability of the Public Administration due to the termination of public concessions (*responsabilidad patrimonial de la Administración* or “RPA”);
- Certain amendments to the legal regime applicable to the calculation and payment of RPA; and
- The creation of a National Evaluation Office (*Oficina Nacional de Evaluación*) to analyze the financial

sustainability of public works and public services concessions before such concessions are awarded.

Reforms to the SIA should resolve uncertainty regarding the interpretation of Article 90.1.6 of the SIA and whether *in rem* rights of security over future credit rights should be construed as pledges without transfer of possession (which is a more complex and expensive type of security) or ordinary pledges. However, it is still unclear how the reforms will be applied by first instance courts in insolvency proceedings when determining whether the requirement of “contract agreement” or “constituted legal relations” has been satisfied.

Reforms to the SPSC Act (which apply to concessions only prospectively) may represent a simpler solution to failed concessions, avoiding intractable situations, such as the yet-unsolved problem of the bankrupt toll highway concessions built around Madrid.

Amendments to the SIA

The PSLR Act amends Article 90.1.6 of the SIA, which has given rise to uncertainty and intense debate among academics and first and second instance courts

regarding the practical application of Article 90.1.6 of the SIA in transactions secured by pledges over future credit rights.

This amendment of the SIA consolidates the jurisprudence of the Spanish Supreme Court in connection with the granting of assignment or pledge agreements over future credit rights (decisions of February 22, 2008 and November 6, 2013).

With the amended language of Article 90.1.6 of the SIA, loans and facilities secured by pledges granted over future credit rights will be deemed to be secured claims with special privileged ranking (*créditos con privilegio especial*) in a debtor's insolvency proceeding, provided that:

- The future credit rights derive from contracts perfected, or legal relations constituted, before the commencement of insolvency proceedings. A pledge over RPA would likely comply with this requirement because the future credit rights derive from a concession contract already executed at the time the pledge was granted. Therefore, holders of pledges over RPA will likely be ranked as secured creditors. We note that courts have ruled in several insolvency proceedings involving toll-highway contractors that RPA pledges are not entitled to preferential status. Those decisions have been appealed. We anticipate that the amended wording of Article 90.1.6 SIA (although not applicable to those cases) will nevertheless be relied upon by the appellate courts in granting preferential status to such RPA pledges.
- The pledge is executed in a public document (i.e., a notarial deed or a notarial policy) or, in the case of pledges without transfer of possession, the security agreement has been registered with the Moveable Assets Registry. As distinguished from ordinary pledges (which are effective vis-à-vis third parties as of their date of execution in a public document), pledges without transfer of possession become effective only as of the date that such pledges are validated by the Registrar of the Moveable Assets Registry, a process that may be time consuming and, potentially, may result in the amendment of the pledge if the Registrar deems it necessary for registration. Because protection is now clearly afforded to ordinary pledges (which do not require red tape and are an unregistered

form of security), it would in most cases make little sense to employ pledges without transfer of possession.

- In the case of credit rights arising from the termination of public work concessions (*contratos de concesión de obra*) or the management of public services concessions (*contratos de gestión de servicios públicos*) and from the public contributions for the construction, use, and exploitation of the concession, preapproval of the granting authority is necessary, as provided in Article 261.3 of the SPSC Act (as amended by the PSLR Act—see *below*). The SIA does not require the relevant public body's prior approval for the granting of pledges over rights arising from the termination of other types of public agreements, such as work agreements (*contratos de obras*), supply agreements (*contratos de suministro*), or cooperation agreements (*contratos de colaboración entre el sector público y el sector privado*).

Amendments to the SPSC Act

Pledges over RPA. The PSLR Act amends Article 261 of the SPSC Act by introducing a new section 3 dealing with the execution of *in rem* rights of pledge over RPA.

These security rights (i) must be preapproved and published in the relevant official gazette by the contracting authority granting the concession over the public works or service; and (ii) will be permitted only to secure debts related to the relevant concession.

This regulation is similar to the system currently applicable to mortgages over concessions.

Amendments to the Legal Regime of RPA. The PSLR Act modifies Articles 271 and 288 of the SPSC Act, and it introduces new Articles 271 Bis and 271 Ter of the SPSC Act, which govern the calculation of RPA.

In this regard, in the event a concession is terminated due to causes attributable to the granting authority, the Public Administration will pay to the contractor the amounts invested in acquiring the land and constructing the concession (taking into account straight-line amortization of the concession).

This amount will be fixed as of the date the concession is terminated and liquidated after six months of the termination date, unless otherwise provided in the particular terms and conditions (*pliego de condiciones particulares*) of the concession agreement.

Pursuant to Article 216 of the SPSC Act, the concessionaire should be paid no later than one month following liquidation of the amount.

The Ministerial Order of the Ministry of Economy and Finances EHA/3362/2010 of December 23, 2010 on accounting standards for contractors of public infrastructure concessions (“Order EHA/3362”) provides that a concession will be subject to straight-line amortization over the duration of the concession, unless amortization can reasonably be calculated according to the demand or utilization of the concession. The practical impact of this amendment is that, in cases where a “demand or utilization” criteria is employed, concessionaires may need to maintain two sets of records, one of which reflects straight-line amortization in the event that it becomes necessary to calculate the indemnity arising from any termination of the concession due to the actions of the Public Administration.

The concessionaire will be entitled to assert a claim for damages against the Public Administration under the following circumstances: (i) the concession is repurchased (*rescate*); (ii) the concession is terminated for reasons of public interest; or (iii) the concession cannot be operated due to actions taken by the granting authority after the concession is granted.

To calculate the amount of damages, the contracting authority will take into account:

- Lost profits, which will be calculated as the arithmetic mean of the profits before taxes that would have been earned by the concessionaire for a term equivalent to the years (and fractions thereto) that remain until the final maturity date of the concession (unless this term is longer than the time elapsed from the beginning of the concession and the date of termination of the concession, in which case the calculation will be made over this latter period of time). The applicable discount rate will be the weighted average cost of capital as reflected in the

concessionaire’s most recent financial statements. It is unclear how this calculation will be performed in the typical case where a concessionaire does not have pre-tax profits during a concession’s ramp-up period.

- Lost value of the assets that would otherwise have been provided to the Public Administration (taking into account their degree of amortization). Unlike in the case of a concession termination caused by the contractor, the amortization method employed in calculating lost asset value would likely be either straight-line or “demand or utilization,” as provided in Order EHA/3362.

In the event a concession is terminated due to the actions of the concessionaire (e.g., the concessionaire is declared insolvent), the Public Administration will pay the concessionaire the concession price no later than three months after the concession is awarded to another concessionaire or the second re-auction (as described below) is not awarded to any bidder.

In any re-auction of the concession, the initial re-auction price will be calculated over the estimated cash flows of the contractor for the period of time between the date of termination of the concession and the final maturity date of the concession (unless this term is longer than the time elapsed from the beginning of the concession and the date of termination of the concession, in which case the calculation will be made over this latter period of time) increased by the interest rate paid from time to time by the 10-year bond issued by the Kingdom of Spain plus 300 basis points (“Initial Concession Auction Price”).

Should the concession not be awarded in the initial re-auction, a second re-auction will take place one month later. In this second re-auction, the initial auction price will be 50 percent of the Initial Concession Auction Price (“Reduced Concession Auction Price”). Should the concession not be awarded to a new concessionaire in this second auction, the value of the concession will be fixed at the Reduced Concession Auction Price. In this case, either the original concessionaire or creditors holding at least 5 percent of the original concessionaire’s debt can propose a new buyer to the contracting authority no later than three months after the second re-auction. This “white knight” will be obligated to pay at least the Reduced Concession Auction Price in order to be awarded the concession.

However, in cases where the construction of a public concession is not complete and the concessionaire causes the termination, the initial re-auction price will be equal to 70 percent of the value of the work actually completed, which may be an incentive for potential bidders to take over the concession.

The PSLR Act does not modify the provisions of the SPSC Act (Article 242) regarding the termination of concessions due to force majeure. In this event, the granting authority will pay the concessionaire an amount equal to the value of work performed plus any debt assumed in connection with the concession. However, the SPSC Act does not specify how such payments are to be calculated.

National Evaluation Office. The PSLR Act creates a National Evaluation Office (“NEO”), which will be required to issue a report on the financial sustainability of any public works or public services concession before the opening of the bidding process. Such a report must be prepared when:

- The construction or development of a concession is backed with public funds or the granting authority provides any other kind of public financing for the concession; or
- A concession tariff in an amount greater than €1 million is assumed in whole or in part by the granting authority.

The report of the NEO will be issued no later than 30 days after the granting authority submits a request for a report, although this period may be reduced to 15 days in cases of emergency.

The findings and conclusions set forth in a NEO report are not binding on the granting authority. However, should the granting authority decide not to follow the NEO’s recommendations, the granting authority must publish its own report detailing the reasons for doing so.

The Spanish autonomous regions (*Comunidades Autónomas*) may opt between adhering to the NEO or, alternatively, in those cases where they have created an office analogous

to the NEO, request the financial sustainability report to their relevant regional evaluation office when the concessions are granted by such regional-level administrations.

Other than provisions regarding the creation of the NEO (which will come into force six months after the publication of the PSLR Act in the Spanish Official Gazette (i.e., on April 1, 2016)), amendments to the SIA and the SPSC Act discussed in this *Commentary* will come into force 20 calendar days following the publication of the PSLR Act in the Spanish Official Gazette (i.e., on October 20, 2015).

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our “Contact Us” form, which can be found at www.jonesday.com/contactus/.

Javier López-Antón

Madrid
+34.91.520.3905
jlopezanton@jonesday.com

Juan Ferré

Madrid
+34.91.520.3904
jferre@jonesday.com

Fernando Lillo

Madrid
+91.520.3989
flillo@jonesday.com

Iván Martín-Barbón

Madrid
+34.91.520.3936
imartinbarbon@jonesday.com