Kluwer Arbitration Blog

What To Expect When You're Expecting Spanish Insolvency

Cecilia Tilve (Herbert Smith Freehills LLP) · Tuesday, March 28th, 2023 · Herbert Smith Freehills

Since 2020 insolvency activity in Spain slowed down because of the moratorium declared by the Spanish government in the wake of Covid-19, under which the obligation to file for insolvency was suspended until 30 June 2022.

Perhaps unsurprisingly, official statistics for the third quarter of 2022 showed a dramatic increase in the insolvency declarations within the Spanish market after the moratorium lifted. The number of insolvent companies increased by 55.5% compared with the same period in 2021.

In this economic context, this post aims to provide concise (although not necessarily exhaustive) answers to some of the issues that may arise when a Spanish party to an arbitration agreement is (or may imminently be) declared insolvent.

PREPARING FOR ARBITRATION vs. INSOLVENCY: THE SPANISH LEGAL FRAMEWORK

The Spanish Recast Insolvency Act ("**SRIA**") entered into force on 1 September 2020. In essence, the interplay between insolvency and arbitration is regulated under article 140 SRIA as follows:

1. The insolvency declaration shall not affect the validity of the arbitration agreements entered by the debtor.
2. Any arbitration proceedings in progress on the date of the insolvency declaration shall continue until the arbitration award becomes final.
3. The insolvency judge, either *ex officio* or at the request of the insolvent party or the insolvency administration, may agree, to suspend the effects of the arbitration agreement once a party becomes insolvent, if he considers it could be detrimental to the processing of the insolvency proceedings. The provisions of international treaties shall remain unaffected.

Article 140 of the SRIA follows the basic principles set out in the previous insolvency regulation, but for some minor changes. Thus, the rulings issued under the previous regulation on the effects of insolvency on arbitration agreements, while limited, still remain relevant. Amongst them, is the 2019 landmark decision of a Santander court which suspended the arbitration agreement between David Guetta and an event organiser who was declared insolvent following the DJ's show cancellation (the "**Guetta Decision**", reviewed in this post). Subsequent rulings have either confirmed or challenged the Guetta Decision's findings, continuing to shape the framework for the

intersection of insolvency and arbitration under Spanish law.

ARBITRATION vs. INSOLVENCY: WHAT HAPPENS WHEN THE TWO COLLIDE

As explained in a previous post, when insolvency and arbitration interconnect, parties and arbitrators face a number of different concerns. Some of these concerns are listed below, together with ideas on how they may be tackled under Spanish law.

Who can request the suspension of the arbitration agreement?

The insolvent party or the insolvency administration can request the suspension of the effects of the arbitration clause. As a novelty, the SRIA also provides for the possibility of the insolvency court suspending the effects of the agreements on its own motion.

Can International arbitration agreements also be suspended?

As explained in the Guetta Decision, neither the New York nor the Geneva Convention deal with the effects that an insolvency declaration under Spanish law may have in an international arbitration agreement.

To determine if Article 140 SRIA also applies when dealing with an international arbitration agreement, the choice of law regime shall be the one provided in the insolvency law instruments applicable in Spain, which include the European Insolvency Regulation ("**EIR**") (on this issue, IBA Toolkit on Insolvency and Arbitration – Spain).

In accordance with Article 7.1 of the EIR, the law applicable to insolvency proceedings and their effects is that of the Member State within the territory of which the insolvency proceedings are opened. Accordingly, international arbitration agreements may be suspended under Article 140 if the insolvency proceedings are subject to Spanish law.

On which grounds can be the arbitration agreement suspended?

The SRIA allows the insolvency judge to suspend the arbitration agreement if they considers that it "*could be detrimental to the processing of the insolvency proceedings*". The question is then: what does "*detrimental*" mean in this context?

Spanish courts have essentially adopted two different positions when approaching this question:

- Position 1: The collective interest of all creditors is to be protected in deciding whether or not the arbitration agreement could be "detrimental". In the Guetta Decision the judge considered it critical that the costs and delay of the potential arbitration proceedings (which were seated in London and based on a vaguely-drafted clause) could be prejudicial to the creditors' estate. A similar rationale was subsequently followed by a Madrid court in a January 2020 decision.

- Position 2: An arbitration agreement can only be suspended if the processing of the insolvency proceedings is compromised from a procedural point of view. Adopting this approach, the aforementioned 2021 decision a Barcelona court dismissed an application for suspension of an arbitration agreement "*in the absence of any justification for exceptional interference with the conduct of the proceedings arising from the arbitration agreement*".

This is a complex issue and the two positions are not easy to reconcile. If only the collective interest of the creditors is considered, one could always argue that the substantial costs of an arbitration are necessarily detrimental when compared to ordinary proceedings before the Spanish courts which are free. However, this proposition seems to clash with the pro-arbitration spirit of Article 140 to the extent that it could justify the suspension of any and all arbitration agreements entered by the debtor.

The formalist approach which requires an interference on the processing of the insolvency does not seem to be the ultimate solution either. The idea of leaving aside the interest of the creditors when considering the suspension of the arbitration agreement also appears to collide with the final objective behind the SRIA enactment of increasing the efficiency and maximise the recovery prospects of creditors.

What proceedings are affected by the suspension of the arbitration agreement?

Arbitration proceedings pending at the date of the declaration of insolvency will not be affected by the suspension of the arbitral agreement. Under Spanish arbitration laws, commencement of the proceedings is set on the date when the respondent receives the request to submit the dispute to arbitration.

If arbitration proceedings have not yet been commenced and the arbitration agreement is then suspended, any arbitration commenced by the creditor against the insolvent party after the suspension takes effect would be invalid.

Until recently, it was not clear whether the suspension of the arbitration agreement took effect if the debtor sought to pursue an action against a creditor. The case law was contradictory on this point as illustrated by this Barcelona court decision. The debate was finally settled in December 2022 in a decision of the Spanish Supreme Court which acknowledged that any actions brought by the debtor are also affected by the suspension of the arbitration agreement.

Which is the competent court if the arbitration agreement is suspended?

Article 140 SRIA does not provide for the competent court in the event the arbitration agreement is suspended. This does not mean, however, that the insolvency court becomes competent to hear any dispute arising from said contract. On the contrary, the Spanish Supreme Court recently confirmed that the jurisdiction to hear disputes arising from any contract in which the arbitration agreement had been suspended would follow the legal rules on jurisdiction in Spain:

- For domestic disputes, the *vis attractiva concursus* rule provided in Article 52 SRIA determines that the insolvency court has jurisdiction to deal with claims of an economic nature brought

against the debtor. However, actions brought by the insolvent party shall be heard by the courts competent in accordance with general rules of attribution of objective jurisdiction.
- For international disputes, general conflicts of laws rules on international jurisdiction applicable to civil and commercial matters shall apply, as explained in the Guetta Decision.

Until when does the arbitration agreement remain suspended?

The suspension of the arbitration agreement does not make it null and void. After the end of the insolvency proceedings, the arbitration clause becomes effective and enforceable.

CONCLUSION

Like in many other jurisdictions, the effects of insolvency on the arbitration agreement under Spanish law follow a pro-arbitration principle, which upholds the validity of the agreement and ensures the continuation of arbitration proceedings which are already underway.

Despite this, the SRIA nonetheless gives full discretion to the judge to suspend the effects of any arbitration agreement entered by the debtor before the arbitration proceedings commence which "*could be detrimental*" to the insolvency proceedings. Spanish courts are making commendable efforts to determine what "*detrimental*" mean in this context, but case law on the matter is contradictory and the question remains unsolved.

In this framework, those who anticipate a dispute with a Spanish counterparty facing financial difficulties may secure the enforceability of the arbitration agreement:

- By commencing the arbitration proceedings before the Spanish counterparty's insolvency is declared; or
- If insolvency has already been declared, by triggering arbitration proceedings before the Spanish judge considers the suspension of the arbitration agreement.

To make sure you do not miss out on regular updates from the Kluwer Arbitration Blog, please subscribe here. To submit a proposal for a blog post, please consult our Editorial Guidelines.

Profile Navigator and Relationship Indicator
Includes 7,300+ profiles of arbitrators, expert witnesses, counsels & 13,500+ relationships to uncover potential conflicts of interest.

Learn how **Kluwer Arbitration** can support you.

Learn more about the newly-updated *Profile Navigator and Relationship Indicator*

This entry was posted on Tuesday, March 28th, 2023 at 8:00 am and is filed under Arbitration, Insolvency, Spain
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.