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[1] Aurelio Gurrea-Martínez is an Assistant Professor of Law at Singapore Management University. For valuable comments to earlier versions of this paper, I would like to thank George Triantis, as well as the participants of various events where I had the opportunity to present preliminary versions of this paper, including the Stanford Program on International Legal Studies Research Seminar, the Ibero-American Institute for Law and Finance Annual Conference, and the 2nd Symposium on Comparative and International Insolvency Law hosted by the University of Miami School of Law. All errors are mine.

Abstract

While filing for bankruptcy does not seem appealing for any debtor regardless of the jurisdiction, the reluctance to use the bankruptcy system varies across countries. This article explores the underlying reasons and economic effects of the low usage of bankruptcy procedures in Spain, where the rate of business bankruptcies is one of the lowest in the world. Some authors have argued that the low usage of bankruptcy procedures in Spain is due to a "cultural" problem faced by Spanish entrepreneurs. According to this hypothesis, the lack of a "bankruptcy culture" makes Spanish entrepreneurs afraid to use the bankruptcy system. In this article, however, I advocate for a totally different hypothesis. In my opinion, the low rate of business bankruptcies in Spain is not due to a "cultural" problem but to an institutional one. Namely, I argue that the low rate of business bankruptcies is better explained by the unattractive insolvency regime for debtors and creditors traditionally existing in Spain, as well as other legal and institutional factors including a creditor-friendly corporate law, an efficient mortgage system, a rigid labor law, and a poor law of secured transactions. All these factors encourage both debtors and creditors to avoid the use of insolvency proceedings either by minimizing the risk of insolvency or by postponing—and, if possible, even avoiding—the bankruptcy system once a debtor becomes insolvent. By exploring the underlying reasons for the low usage of the bankruptcy system in Spain, this article seeks to contribute to the general understanding of the low rate of business bankruptcies around the world while assessing the economic effects potentially associated with a low usage of insolvency proceedings. The article concludes with several recommendations to enhance the attractiveness of Spanish bankruptcy procedures.

I. INTRODUCTION

Insolvency law may have a significant impact on entrepreneurship, innovation and firms' access to finance.[2] Therefore, from a policy perspective, it seems particularly relevant to analyze the operation of a bankruptcy system as a means to determine its potential impact on the real economy.[3] In that context, a high or low usage of the bankruptcy system is not necessarily good or bad for society. It will depend on the *underlying reasons* associated with the use of bankruptcy procedures.[4]

As shown in Table 1, Spain has one of the lowest business bankruptcy rates in the world (that is, the number of business bankruptcies per number of firms). For instance, in 2006, while there were 2.6 business bankruptcies per 10,000 firms in Spain, other developed economies such as Italy, the United States, Germany, the United Kingdom, or France exhibited a number of business bankruptcies of 25.5, 33.5, 96.3, 114.7 and 178.6, respectively, per 10,000 firms. The low rate of business bankruptcies in Spain increased in 2010, as a result of the Spanish economic crisis. However, as it is shown, even in the middle of one of the harshest economic crises in the history of the country, the rate of business

[2] Philippe Aghion, Oliver Hart & John Moore, *The Economics of Bankruptcy Reform*, *in* THE TRANSITION IN EASTERN EUROPE 215-244 (Olivier Blanchard, Kenneth Froot and Jeffrey Sachs eds., Chicago University Press, Volume 2, 2004); Rafael La Porta, Florencio López de Silanes, Andrei Shleifer & Robert Vishny, *Legal Determinants of External Finance*, 53 J. OF FIN. 1131 (1997); Jeremy Berkowitz & Michelle J. White, *Bankruptcy and Small Firms' Access to Credit,* 35 RAND J. ECON. 69 (2004); Kenneth Ayotte, *Bankruptcy and Entrepreneurship: The Value of a Fresh Start*, 23 J.L., ECON. & ORG. 161 (2007); John Armour & Douglas Cumming, *Bankruptcy Law and Entrepreneurship*, 10 AM. L. & ECON. REV. 303 (2008); Sergei A. Davydenko & Julian R. Franks, *Do Bankruptcy Codes Matter? A Study of Default in France, Germany and the UK*, 63 J. OF FIN. 565 (2008); Viral V. Acharya & Krishnamurthy Subramanian, *Bankruptcy Codes and Innovation*, 22 REV. OF FIN. STUDIES 4949 (2009); Viral V. Acharya, Rangarajan K. Sundaram & Kose John, *Cross-Country Variations in Capital Structures: The Role of Bankruptcy Codes*, 20 J. OF FIN. INTERMEDIATION 25 (2011); John Armour, Antonia Menezes, Mahesh Uttamchandani, & Kristin van Zwieten, *How do Creditor Rights Matter for Debt Finance? A Review of Empirical Evidence*, *in* RESEARCH HANDBOOK ON SECURED FINANCING OF COMMERCIAL TRANSACTIONS 3–25 (Frederique Dahan ed., Edward Elgar, 2015).

[3] While the expressions 'bankruptcy law' and 'bankruptcy procedures' are generally used in the United States, most countries around the world use the words 'insolvency law' and 'insolvency proceedings', respectively. Actually, some of these latter countries only use the word 'bankruptcy' to refer to personal insolvency. This paper will use the words 'bankruptcy procedures' and 'bankruptcy law' and 'insolvency proceedings' and 'insolvency law', respectively, as synonyms.

[4] For the pioneer study in this field, *see* Stijn Claessens & Leora F. Klapper, *Bankruptcy around the World: Explanations of Its Relative Use*, 7 AM. L. & ECON. REV. 253 (2005).

bankruptcies in Spain remained lower than most of its European counterparties.

Table 1. Bankruptcy procedures per 10,000 firms		
Country	**2006**	**2010**
Spain	2.6	14.6
Portugal	15	37.4
Italy	25.5	25.3
United States	33.5	97.8
Finland	96.6	105.9
Germany	96.3	89.1
United Kingdom	114.7	137.3
Hungary	135	305.3
France	178.6	216.6
Austria	239.8	212.2
Belgium	107.2	124.1
Source: Miguel García-Posada and Juan S. Mora-Sanguinetti, *El uso de los concursos de acreedores en España*, Banco de España (2012)		

While Spain exhibits one of the world's lowest business bankruptcy rates, the low usage of bankruptcy procedures is not just a Spanish phenomenon. Other studies have shown that entrepreneurs do not often use the bankruptcy system in other jurisdictions, particularly in Asia and Latin America.[5] Therefore, by exploring the reasons and potential implications of the low usage of bankruptcy procedures in Spain, this paper seeks to contribute to the general understanding of the relative use of bankruptcy law as well as the economic effects potentially associated with a lower usage of the insolvency system.[6]

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[5] *Id.* at 261; Liu Mingkang & Wei Chuyi, *Towards a Better Future for Chinese Bankruptcy Law: Problems and Potential*, LAU CHOR TAK INST. OF GLOBAL ECON. & FIN., (Dec. 2017), http://www.igef.cuhk.edu.hk/igef_media/working-paper/IGEF/igef%20working%20paper%20no.%2062%20english%20version.pdf.

[6] For a first attempt to explore the low rate of business bankruptcy in Spain, *see* Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* 1 (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010). For further studies mainly analyzing the impact of the mortgage system on the use of bankruptcy procedures in Spain, *see* Miguel García-Posada, *Insolvency Institutions and Efficiency: The Case of Spain* (BANCO DE ESPAÑA WORKING PAPERS NO. 1302, 2013); *see also* Miguel García-Posada & Juan S. Mora-Sanguinetti, *Are*

Some authors have previously argued that the low usage of bankruptcy procedures in Spain is due to a lack of a "bankruptcy culture". In other words, they argue that entrepreneurs do not often have the reorganization culture existing in other countries, and they are afraid of using the bankruptcy system. Against this hypothesis, this article argues that the low rate of business bankruptcy in Spain is not due to a cultural problem but to an *institutional* one. Namely, it will be argued that the low rate of business bankruptcies is better explained by the unattractive insolvency regime traditionally existing in Spain, as well as other legal and institutional factors including a creditor-friendly corporate law, an efficient mortgage system, a rigid labor law, and a poor law of secured transactions. All these factors encourage debtors and creditors to avoid the use of insolvency proceedings by either minimizing the risk of insolvency (e.g., reducing the level of debt or risk taking borne by a company) or by postponing—and, if possible, even avoiding—the bankruptcy system once a debtor becomes insolvent.

The paper is divided as follows. Section II analyzes the relative use of bankruptcy procedures, examining the role of insolvency law in the promotion of economic growth. Section III explains why the low rate of business bankruptcies in Spain is probably due to an unattractive insolvency system, as well as other legal and institutional factors including a creditor-friendly corporate law, a rigid labor law, and a poor law of secured transactions. Section IV proposes some policy recommendations to enhance the attractiveness of the institutional framework for debtors and creditors in Spain. Section V concludes.

II. THE RELATIVE USE OF BANKRUPTCY LAW

a. The role of bankruptcy law in the promotion of economic growth

The law and finance literature has shown the importance that the protection of creditors' and shareholders' rights may have for the promotion of firms' access to finance and the development of capital markets.[7] For that purpose, most studies have measured the degree of

there alternatives to bankruptcy? A study of small businesses distress in Spain, 5 J. OF THE SPANISH ECON. ASS'N 287 (2014).

[7] Rafael La Porta, Florencio López de Silanes, Andrei Shleifer & Robert Vishny, *Legal Determinants of External Finance*, 52 J. OF FIN. 1131 (1997); Rafael La Porta, Florencio López de Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. OF POL. ECON. 1113 (1998); Rafael La Porta, Florencio Lopez de Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J. OF ECON. LITERATURE 285 (2008).

shareholder protection based on several indexes related to the allocation of powers between directors and shareholders.[8] In contrast, the level of creditor protection has been traditionally measured as the result of a country's bankruptcy and secured transaction laws, as well as the quality and efficiency of the mechanisms for debt enforcement.[9]

The level of creditor protection in bankruptcy depends on a variety of factors, including: (i) whether the law provides (or not) an automatic stay; (i) who should (or is allowed to) file for reorganization or liquidation; and (iii) the weight given to the debtor, the creditors, and the company´s managers in bankruptcy.[10]

Even though there might be a disagreement about what to understand as an 'optimal' bankruptcy law, most authors seem to agree that a good insolvency regime should promote both *ex ante* and *ex post* efficiency.[11] *Ex ante efficiency* can be achieved if an insolvency regime creates the rights incentives to promote entrepreneurship and access to finance. Likewise, *ex post efficiency* in bankruptcy can be achieved if the debtor´s assets are put to their best use, and therefore the creditors can maximize their returns.

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[8] Rafael La Porta, Florencio López de Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. OF POL. ECON. 1113 (1998); Mathias Siems, *Shareholder Protection Around the World,* 33 DEL. J. OF CORP. L. 111 (2008); John Armour, Simon Deakin, Viviana Mollica & Mathias Siems, *Law and Financial Development: What We Are Learning From Time Series Evidence*, 2009 BYU L. REV. 1435 (2009).

[9] For a general overview of variables regarding creditor protection in bankruptcy, *see* Rafael La Porta, Florencio López de Silanes, Andrei Shleifer & Robert Vishny, *Law and Finance*, 106 J. OF POL. ECON. 1113 (1998); Vaughn H. Armstrong & Leigh A. Riddick, *Bankruptcy Law Differences Across Countries, Managerial Incentives and Firm Value* (SSRN WORKING PAPER, Jan. 2003), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=420560; Sergei A. Davydenko & Julian R. Franks, *Do Bankruptcy Codes Matter? A Study of Default in France, Germany and the UK*, 63 J. OF FIN. 565 (2008); Viral V. Acharya, Yakov Amihud & Lubomir Litov, *Creditor Rights and Corporate Risk-Taking* (NBER WORKING PAPER SERIES, 15569), http://www.nber.org/papers/w15569.pdf; Viral V. Acharya & Krishnamurthy Subramanian, *Bankruptcy Codes and Innovation*, 22 REV. OF FIN. STUDIES 4949 (2009); John Armour, Simon Deakin, Viviana Mollica & Mathias Siems, *Law and Financial Development: What We Are Learning From Time Series Evidence*, 2009 BYU L. REV. 1435 (2009). For a study analyzing the importance of debt enforcement from a comparative perspective, *see* Simeon Djankov, Oliver Hart, Carale McLiesh & Andrei Shleifer, *Debt Enforcement Around the World*, 116 J. OF POL. ECON. 1105 (2008).

[10] *Id.*

[11] Philippe Aghion, Oliver Hart & John Moore, *The Economics of Bankruptcy Reform*, 8 J. OF L., ECON. & ORG. 523 (1992); Lucian A. Bebchuk, *Using Options to Divide Value in Corporate Bankruptcy*, 44 EUR. ECON. REV. 829 (2000); Oliver Hart, *Different Approaches to Bankruptcy* (NBER WORKING PAPER NO. 7921, 2000), http://www.nber.org/papers/w7921.pdf.

While most empirical studies have focused their attention on the impact of insolvency law on firms' access to finance,[12] and therefore on the capital structure of firms, bankruptcy law has also proven to affect innovation, entrepreneurship, and the *asset* structures of firms.[13] For example, in a country with a poor creditor protection in bankruptcy, lenders may respond *ex ante* by requiring more collateral.[14] Therefore, firms may have incentives to invest (or over-invest) in non-specific assets that can be easily given as debt collateral. As a result, the design of insolvency law may ultimately affect the level of innovation and type of assets potentially held by most companies in a country.[15] Moreover, since these assets may be less risky than non-tangible assets, this particular asset structure may reduce the risk of insolvency of a firm. Therefore, an institutional factor (e.g., poor creditor protection in bankruptcy) may ultimately lead to an economic problem (e.g., lack of innovation) that might be reflected in a low number of business bankruptcies.

This paper does not argue that a high number of business bankruptcies is necessarily good. In fact, a high rate of business bankruptcies can be equally undesirable, not only for the destruction of value potentially generated *ex post*, but also for other factors potentially associated with the design of the insolvency framework. For example, if the high rate of business bankruptcies is the result of an excessively debtor-oriented jurisdiction where creditors are not adequately protected, lenders might respond *ex ante* by increasing the cost of debt (including requiring more collateral) and being more reluctant to lend money.[16] Therefore, the higher

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[12] See John Armour, Antonia Menezes, Mahesh Uttamchandani & Kristin van Zwieten, *How do Creditor Rights Matter for Debt Finance? A Review of Empirical Evidence*, *in* RESEARCH HANDBOOK ON SECURED FINANCING OF COMMERCIAL TRANSACTIONS 3–25 (Frederique Dahan ed., Edward Elgar, 2015) (summarizing the empirical literature analyzing the impact of creditor protection and insolvency reforms on firms' access to finance).

[13] *See generally* Raghuram G. Rajan & Luigi Zingales, *What Do We Know about Capital Structure? Some Evidence from International Data*, 50 THE J. OF FIN. 1421 (1995); *see also* Viral V. Acharya, Rangarajan K. Sundaram & Kose John, *Cross-Country Variations in Capital Structures: The Role of Bankruptcy Codes*, 20 J. OF FIN. INTERMEDIATION 25 (2011).

[14] Sergei A. Davydenko & Julian R. Franks, *Do Bankruptcy Codes Matter? A Study of Default in France, Germany and the UK*, 63 THE J. OF FIN. 565, 566 (2008).

[15] *See* Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010); *see also* Miguel García-Posada, *Insolvency Institutions and Efficiency: The Case of Spain* (BANCO DE ESPAÑA WORKING PAPERS NO. 1302, 2013).

[16] *See* Davydenko & Franks, *supra* note 2. Actually, this seems to be the case of France (a country with a high rate of business bankruptcies, as shown in Table 1). Miguel García-Posada & Juan S. Mora-Sanguinetti, *El uso de los concursos de acreedores en España*, BANCO DE ESPAÑA tbl. 1 (2012).

or lower usage of the bankruptcy system is not necessarily good or bad for society. It will depend on the underlying reasons supporting these data.

In a seminal work about the relative use of bankruptcy law around the world, Claessens and Klapper showed three primary findings.[17] First, the number of business bankruptcies are higher in *common-law countries* with market-oriented financial systems. Second, greater *judicial efficiency* is associated with a higher use of bankruptcy, though – interestingly- the combination of stronger creditors' rights and greater judicial efficiency is associated with a lower use of the bankruptcy system. Third, the presence of an *automatic stay* for secured creditors (which, at first glance, might seem an undesirable policy for secured creditors, who might be interested in enforcing their claims and taking back their collateral, unless they are out of the money), is associated with a higher use of bankruptcy. Therefore, since the findings were a bit unclear, the authors concluded that the relationship between creditor rights and the use of bankruptcy systems is more complex than it may be previously thought.

Likewise, other authors have focused their attention on the trade-off between *ex ante* and *ex post* efficiency, and the role of *third parties* (usually judges and/or insolvency practitioners) in the overall efficiency of bankruptcy procedures.[18] And as these factors may affect the attractiveness of the insolvency system, they can ultimately have an effect on the higher or lower usage of bankruptcy procedures.

Namely, it has been argued that bankruptcy law either allocates significant control rights to third parties or allows them to mediate in the allocation of these rights to debtors and creditors. Thus, by using third parties as a credible channel for providing information, both debtors and creditors may enhance *ex post efficiency*.[19] Nevertheless, the ability of these third parties to enhance *ex post* efficiency –without undermining *ex ante* efficiency– depends on their ability to determine whether the company´s assets are worth more as a going concern or in a piecemeal liquidation.[20] In other words, the desirability of the intervention of these third parties will depend on their ability to minimize the so-called *type I* and *type II* errors, that is, those errors associated with: (i) maintaining a firm as a going concern when it is worth more in a piecemeal liquidation *(type I error*); and (ii) liquidating piecemeal a firm that is worth more as a

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[17] *See* Stijn Claessens & Leora F. Klapper, *Bankruptcy around the World: Explanations of Its Relative Use*, 7 AM. L. AND ECON. REV. 253 (2005).
[18] *See* Kenneth Ayotte & Hayong Yun, *Matching Bankruptcy Laws to Legal Environments*, 25 THE J. OF L., ECON. & ORG. 1 (2007).
[19] *Id.*
[20] *See id.*

going concern (*type II error*).[21] Based on these arguments, the authors conclude that the optimal trade-off between *ex ante* and *ex post* efficiency in the design of bankruptcy law depends on the ability and expertise of these third parties to efficiently assign control rights in bankruptcy.[22] If these parties have the authority and expertise to (promptly) separate viable and non-viable firms, bankruptcy law should make use of their abilities to promote *ex post efficiency*. By contrast, when judges and/or insolvency practitioners have low abilities in discerning viable and non-viable firms, it might make sense for the legislator to favor *ex ante efficiency*, and therefore to design a more creditor-oriented bankruptcy law.[23] Finally, and perhaps more importantly for the purpose of this paper, the authors conclude that when bankruptcy codes do not provide enough creditor protection to achieve *ex post* efficiency, lenders have incentives to write their contracts to resolve financial distress *outside* of bankruptcy.[24] Therefore, a poor creditor protection in bankruptcy can be ultimately associated with a low usage of bankruptcy procedures.

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[21] Michelle J. White, *Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructuring*, 10 THE J. OF L., ECON. & ORG. 268, 269 (1994) (using the term 'type I' and 'type II' errors). *See also* Michelle J. White, *The costs of corporate bankruptcy: A U.S.-European comparison*, *in* CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVE 467-500 (Jagdeep S. Bhandari & Lawrence A. Weiss eds., Cambridge University Press 1996).

[22] Kenneth Ayotte & Hayong Yun, *Matching Bankruptcy Laws to Legal Environments*, 25 THE J. OF L., ECON. & ORG. 1 (2007).

[23] *Id*.

[24] *See* Michelle White, *The Corporate Bankruptcy Decision,* 3 J. OF FIN. PERSPECTIVES 129 (1989); Douglas Baird, *The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of Financially Distressed Firms* 9–10 (CHICAGO WORKING PAPER IN LAW & ECONOMICS 1, 1997); John Armour, *The Law and Economics of Corporate Insolvency: A Review*, 3–4 (ESRC CENTRE FOR BUSINESS RESEARCH, UNIVERSITY OF CAMBRIDGE, WORKING PAPER NO 197, 2001); Alan Schwartz, *A Normative Theory of Corporate Bankruptcy*, 91 VIRGINIA L. REV. 1199 (2005*)*. For the purpose of this paper, *financial distress* means any situation in which the debtor is unable to pay its debts as they become due. Therefore, it is a problem necessarily held by *leveraged firms*, since it implies the existence of debt, and it can be solved by restructuring the capital structure of the firm. This concept must be distinguished from *economic distress*, which is generally used to refer to those companies whose assets are worth more in a piecemeal liquidation or below zero at their current use. *See also United Airlines, Inc. v HSBC Bank USA, N.A.*, 416 F.3d 609, 612-13 (7th Cir. 2005) (holding that "many provisions in the US Bankruptcy Code (…) are designed to distinguish financial from economic distress. A firm that cannot meet its debts as they come due, but has a positive cash flow from current operations, is in financial but not economic distress. It is carrying too much debt, which can be written down in a reorganization. A firm with a negative cash flow, by contrast, is in economic distress and liquidation may be the best option").

b. *The low use of bankruptcy procedures: reasons and explanations*

Firms can avoid the use of the bankruptcy system in two primary ways: (i) by avoiding *ex ante* the risk of insolvency; or (ii) by resolving *ex post* the debtor´s financial trouble without using formal bankruptcy procedures. Therefore, as it will be mentioned, this reluctance to the use of bankruptcy procedures can be due to a variety of factors.

i. How companies can avoid the bankruptcy system

There are several strategies to minimize *ex ante* the risk of insolvency. The most extreme ones include not starting a new business or, if so, not taking any risks and not borrowing money.[25] However, while these measures would reduce the risk of insolvency, and therefore the likelihood of bearing the direct and indirect costs associated with a situation of insolvency, they can harm entrepreneurship, innovation, and access to financing.[26]

Instead of, or along with, minimizing *ex ante* the risk of insolvency, a firm might decide to take on optimal levels of risk and debt but, once it becomes insolvent, avoid the use of the bankruptcy system. They can do so in different ways. First, once a company faces financial trouble, secured creditors may use the mortgage system, rather than the bankruptcy system, to enforce their claims. Under this alternative, the secured creditors may seize some of the most valuable assets of the firm, usually hampering the firm's ability to keep operating. Therefore, the company will probably end up in a piecemeal liquidation where going concern value might be lost. Therefore, this scenario not only can be undesirable for entrepreneurship, job creation and the efficient allocation of assets, but also to promote firms' access to finance since the pie available for the creditors can be reduced and they might respond *ex ante* with an increase in the cost of debt.

Second, other companies may decide to shut down their businesses without following a formal procedure. Under this option, the company would do nothing but just wait and see if the creditors exercise any legal actions against the company or the directors. If not, the company may stay legally alive for a long period of time, even if it has no economic activity. Again, this scenario can also destroy value. Some firms may decide to shut

[25] Aurelio Gurrea Martínez, EL DERECHO CONCURSAL EN ESPAÑA: PROBLEMAS ESTRUCTURALES Y PROPUESTA DE REFORMA, 8 (Reus, 2018).
[26] *Id.*

down their businesses just because, despite the fact of being economically viable, they may have become insolvent and they are afraid of using the bankruptcy system. As a result, going concern value can be lost, and only those creditors who are either sophisticated or closer enough to the debtor may recover part of their claims if they quickly initiate legal actions against the company.

Finally, firms can avoid *ex post* the bankruptcy system by using workouts as a mechanism to sort out their financial trouble. Under this scenario, if a viable but insolvent firm reaches an out-of-court agreement, this option can save the direct and indirect costs associated with bankruptcy procedures. Therefore, not only will the debtor suffer a lower destruction of value but there will also be a bigger pie available for the creditors. As a result, this scenario will be *ex post* efficient without harming *ex ante* efficiency since the debtor did not take a suboptimal level of risk or debt as a means to reduce the risk of insolvency.

ii. Why companies may want to avoid the bankruptcy system

Many authors and experts in Spain have pointed out that the low usage of bankruptcy procedures is due to a cultural problem.[27] Specifically, they argue that the lack of an entrepreneurial and bankruptcy "culture" discourages many companies from using the bankruptcy system in Spain.

While this "cultural" or "sociological" explanation for the low use of bankruptcy procedures seems to have some support, not only in Spain but also abroad,[28] this paper provides an alternative explanation for the understanding of the relative use of bankruptcy. In my opinion, even though the reluctance to insolvency proceedings may indeed exist, this is not the result of any cultural or sociological factors but the product of an unattractive institutional framework for debtors and creditors. This hypothesis will be detailed in section IV. Before getting into the details of this explanation, however, it would be useful to provide a general overview about the legal and institutional framework to deal with financial distress in Spain.

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[27] For a summary of the authors supporting this hypothesis, *see* Gurrea-Martinez, El Derecho concursal (2018) *supra* note 25, at 43–44.

[28] Tibor Tajti, *Bankruptcy stigma and the second chance policy: the impact of bankruptcy stigma on business restructurings in China, Europe and the United States*, 6 CHINA-EU L.J. 3, 1 (2018).

III. TOWARD AN INSTITUTIONAL EXPLANATION OF THE LOW USE OF BANKRUPTCY PROCEDURES IN SPAIN

a. *The unattractiveness of Spanish insolvency proceedings*

Unlike other insolvency systems, which might be classified as 'debtor-friendly' or 'creditor-friendly', the Spanish insolvency has been classified as anti-creditor and anti-debtor.[29] From the debtor's perspective, debtors are exposed to a very harsh liability regime under Spanish bankruptcy law. First, the Spanish Insolvency Act 2003 establishes the old-fashioned 'labelling' of debtors mentioned above, by which debtors might end up being classified as 'guilty' even if they show that the situation of insolvency was generated or exacerbated by reasons totally unrelated to the debtor´s actions. Second, the directors, under some circumstances, might be liable for the company´s unpaid debts, in addition to being disqualified. Third, debtors do not enjoy a cross-class cramdown for the approval of reorganization plans. Fourth, debtors are always subject to the supervision of a trustee and pay for the honorarium of these professionals. Fifth, the Spanish insolvency proceeding is very formalistic not only in the sense that most actions from the debtor require approval by the trustee and/or the bankruptcy judge, but also by the fact that certain solutions potentially adopted to turn around the company (e.g., certain M&A transactions) are often discouraged. Finally, individual debtors do not enjoy an effective discharge of debts, since they are not allowed to discharge most of their debts, including those held by secured creditors and certain preferential creditors (e.g., public creditors).

While the Spanish insolvency regime does not look very attractive to debtors, it does not get much better from the perspective of the creditors. First, since the Spanish Insolvency Act imposes harsher consequences in liquidation than in reorganization, firms do not have incentives to voluntary file for liquidation, even if a firm is not economically viable or the business is economically attractive but the company is managed by the wrong people. Moreover, as the creditors cannot force the liquidation of the company or the sale of assets even if the debtor is not an economically viable firm or they do not trust the shareholders/managers, value can be destroyed.

Second, creditors do not enjoy some individual protections existing in other countries to make sure that the assets are allocated efficiently. For example, the Spanish Insolvency Act does not provide creditors with the protection of the 'best interest of creditor test' existing in the US Chapter

[29] *See* Aurelio Gurrea Martinez, EL DERECHO CONCURSAL EN ESPAÑA: PROBLEMAS ESTRUCTURALES Y PROPUESTA DE REFORMA (Reus, 2018).

11.[30] Therefore, dissenting creditors can be forced to accept a plan even if they prove that they would be better off under a piecemeal liquidation.

Third, the absolute priority rule is not strictly respected in Spain. Therefore, the shareholders can get value out of the corporation even if the creditors have not been paid in full. Fourth, unsecured creditors cannot create a committee of creditors paid by the estate even if they think it would be a valuable mechanism to protect their interest – especially in the case of large bankruptcy procedures.

Finally, secured creditors can be subject to the opportunistic use of the automatic stay by non-economically debtors, since the debtor´s viability is not a requirement to use the stay. Moreover, unlike what happens in other countries (e.g., USA), secured creditors who are stopped from enforcing their claims cannot ask for adequate protection.

Therefore, even though the Spanish bankruptcy system is not very appealing for debtors, it does not seem attractive for creditors either.

b. The efficiency of the mortgage system

Once a debtor becomes unable to pay their debts, creditors are allowed to enforce their claims and seize the debtor´s assets. This process can be made collectively through the use of bankruptcy procedures, or it can be made individually by the creditors. When a claim is secured by a mortgage, the creditor may choose an alternative venue for debt enforcement: the mortgage system.

As shown in Table 2, the mortgage system is much faster than the bankruptcy system in Spain. Therefore, secured creditors in Spain have strong incentives to prefer the mortgage system. However, it should be kept in mind that the mortgage system is not a *perfect substitute* of the bankruptcy system. On the one hand, it is not a *collective* procedure. Therefore, while the mortgage system can be preferred by an individual (secured) creditor, it may make the creditors as a whole worse off since going concern value (if any) can be lost. On the other hand, under Spanish insolvency law, an *insolvent* debtor must file for bankruptcy even if its main assets have been liquidated through the mortgage system or the debtor initiated a voluntary dissolution process. Therefore, the use of the mortgage system does not act as a *real* substitute to the bankruptcy system.[31]

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[30] *See* 11 U.S.C. § 1129(a)(7) (2005)

[31] For an analysis of the mortgage system as a debt enforcement mechanism in Spain, and how it interacts with the bankruptcy system, see Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010); Miguel García-Posada, *Insolvency Institutions and Efficiency: The Case of Spain* (BANCO DE

Table 2. Length of procedures of debt enforcement in 2007			
Type of procedure	**Spain**	**France**	**United Kingdom**
Mortgage enforcements	7-9 months	15-25 months	8-12 months
Bankruptcy procedures	20-23 months	14 months	Less than 12 months
Source: Miguel García-Posada and Juan S. Mora-Sanguinetti, *Are there alternatives to bankruptcy? A study of small businesses distress in Spain*, 5 J. OF THE SPANISH ECON. ASS'N 287 (2014).			

Besides, as it has been mentioned, while the use of the mortgage system is more efficient for secured creditors, it is not costless from a social welfare perspective. From an *ex post* perspective, it may destroy the going concern value of economically *viable* firms. And if so, it will reduce the pie available for distribution, harming firms' access to debt finance.[32]

Likewise, the use of the mortgage system may generate various inefficiencies *ex ante*. On the one hand, it may encourage firms to overinvest in non-specific assets that can be easily used as debt collateral such as equipment and real estate.[33] Therefore, firms may reduce their investments in innovation, research and other valuable assets.[34]

On the other hand, if the company´s assets are mainly given as debt collateral, secured creditors will have high incentives to closely monitor the firm. Therefore, while this behavior may reduce agency problems (and particularly monitoring costs) between shareholders and managers, it will

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ESPAÑA WORKING PAPERS NO. 1302, 2013); Miguel García-Posada & Juan S. Mora-Sanguinetti, *Are there Alternatives to Bankruptcy? A Study of Small Businesses Distress in Spain*, 5 J. OF THE SPANISH ECON. ASS'N 287 (2014).

[32] Analyzing the relationship between creditor protection and access to debt finance, see *supra* note 12.

[33] Miguel García-Posada, *Insolvency Institutions and Efficiency: The Case of Spain* (BANCO DE ESPAÑA WORKING PAPERS NO. 1302, 2013).

[34] Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010).

likely encourage firms to bear a low level of risk since senior lenders (unlike the shareholders) have incentives to be risk averse. Therefore, firms may give up, at the expense of society, many projects with a high positive net present value but high volatility.

c. *Creditor-friendly corporate law*

Corporate law can also reduce the risk of insolvency, particularly in countries like Spain, where the law is very protective of the interests of the creditors. Indeed, unlike other jurisdictions such as the United States, where corporate law is mainly designed to maximize the interest of the shareholders, Spanish corporate law is very creditor-oriented. This orientation implies that, under some circumstances, the conflicts between shareholders and creditors will be resolved in favor of the latter. For this reason, Spanish corporate law has traditionally imposed several measures to protect creditors, including: (i) a minimum legal capital; (ii) several provisions regarding capital maintenance and distribution of dividends; (iii) various provisions requiring creditors' consent for certain corporate transactions (e.g., mergers, reduction of capital, etc.); and (iv) the imposition of personal liability for the corporate´s debts to those directors that fail to promote the dissolution, restructuring or initiation of a bankruptcy procedure within two months upon the company´s *net* assets falling below 50% of the company´s legal capital.[35] Therefore, these provisions, and especially the last one, may serve as a powerful mechanism to minimize the risk of insolvency, since firms will have less incentives to use debt, especially taking into account that most companies in Spain are small firms and they do not usually hire insurance for their officers and directors.[36] This reason may explain why, as shown in Table 3, Spanish companies have a higher capital ratio (equity/total assets) than other European counterparties, as well as why Spain seem to have a lower

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[35] See article 367.1 of the Spanish Companies Act. Since 2005, however, these debts were limited to those incurred by the corporation from the moment in which its net assets were below 50% of the company´s legal capital. Before this reform, corporate directors were personally liable for all the company's debts.

[36] Small and medium-sized enterprises represent 99.84% of the companies in Spain. *See* https://industria.gob.es/es-es/Servicios/MarcoEstrategicoPYME/Marco%20Estrat%C3%A9gico%20PYME.pdf. Likewise, only 14% of small firms hire insurance for their officers and directors. *See https://cisscontablemercantil.ciss.es/Content/Documento.aspx?params=H4sIAAAAAAAEAMtMSbF1jTAAAkNDcwMTC7Wy1KLizPw8WyMDQzNDIwNLkEBmWqVLfnJIZUGqbVpiTnGqWm5iSUlqka1zfl5JYlIOjO-dWmnr6xjiGuTpCADlFqEHVwAAAA==WKE*

proportion of balance-sheet insolvent firms than, for example, France, Germany or the United Kingdom.[37]

Table 3. Capital Ratio (Equity/Total Assets)				
	SMEs		**Total companies**	
Country/Year	**2006**	**2011**	**2006**	**2011**
Spain	40%	45%	37%	38%
Germany	32%	35%	31%	32%
France	32%	32%	32%	32%
Italy	26%	31%	29%	31%
Source: BACH, Outlook 1, SMEs in European countries, October 2013 (available at https://www.bach.banque-france.fr/?page=archives)				

Therefore, even if, as some authors have mentioned, some of these creditor-oriented provisions do not clearly provide an effective protection to creditors,[38] they may reduce the risk of insolvency by incentivizing firms to minimize the use of debt or by pursuing projects with lower volatility. Moreover, by making the directors personally liable for the company´s debts incurred after the company´s net assets fall below 50%

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[37] *See* Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* 1 (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010). In fact, even in insolvency, many Spanish companies seems to be balance-sheet solvent. Namely, according to Van Hemmen, 69.02% of companies subject to a formal bankruptcy procedure in Spain in 2011 had *positive* net assets. This percentage was similar in 2010, and even greater in 2009, when 86.6% of the companies in bankruptcy have positive net assets. *See* Estefan Van Hemmen, *Estadística Concursal 2011: el Concurso de Acreedores en Cifras,* 17-18 (COLEGIO DE REGISTRADORES DE LA PROPIEDAD, BIENES MUEBLES Y MERCANTILES DE ESPAÑA 2012). We must note, however, that these data reflect accounting values. Therefore, letting aside the event of accounting fraud, it would be possible to find companies with positive net assets on an accounting basis but balance-sheet insolvent on a market basis.

[38] Luca Enriques and Jonathan Macey, *Creditors Versos Capital Formation: The Case Against The European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1188 (2001); John Armour, *Legal Capital: An Outdated Concept?*, 1 EUR. BUS. ORG. L. REV. 5 (2006). Moreover, it should be noted that professional lenders have the ability to protect themselves, and many non-adjusting creditors (e.g., tort claimants and employees) are properly protected under Spanish bankruptcy law, since they enjoy a preferential treatment in the scheme of distribution.

of the legal capital, the legislator also encourages many viable companies reporting losses (which is actually the typical situation of many start-ups) to leave the market. Therefore, in addition to contributing to the low rate of business bankruptcies in Spain, this creditor-oriented corporate law can harm entrepreneurship, innovation, access to finance and the survival of viable companies temporarily reporting losses.

d. Secured transactions laws and practice

The law and practice of secured transactions existing in Spain may also play a major role in the design of the asset and capital structures of Spanish firms. Therefore, it may indirectly affect the risk of insolvency, and ultimately the rate of business bankruptcies. On the one hand, the system of secured transactions has not traditionally favored the use of non-fixed tangible assets as debt collateral. Therefore, Spanish firms have based their asset structures toward real estate and other non-innovative assets such as machinery.[39] On the other hand, Spanish banks have traditionally lent money on a secured (or over-secured) basis instead of making their financial decisions based on the *viability* of a business project. Therefore, this practice of bank lending, probably generated as a result of poor creditor protection as well as the incentives or impositions created by banking regulations (particularly compliance with Basel Capital requirements), has exacerbated the problem associated with the inefficient design of the asset structure of Spanish firms. Moreover, this practice also encourages or, at least, allows banks to invest in negative net present value projects provided that the debtor provides a collateral when rejecting positive net present value projects just because a debtor is unable to provide the lender with a security interest. Therefore, this practice of bank lending also creates overinvestment and underinvestment problems,[40] respectively, which can be harmful for the efficient allocation of resources in the economy. Therefore, not only are Spanish banks not performing one of the key economic functions that justify their existence (and part of their fees), which is financing value-creating projects and

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[39] *See* Marco Celentani, Miguel García-Posada & Fernando Gómez, *The Spanish Business Bankruptcy Puzzle and the Crisis* 1 (FUNDACIÓN DE ESTUDIOS DE ECONOMÍA APLICADA, Working Paper NO. 2010-11, Mar. 2010).

[40] The concept of underinvestment projects refers to those situations in which a valuable project cannot be pursued, usually due to the lack of finance. *See* Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions: When Firms Have Information the Investors Do Not Have*, 13 J. OF FIN. ECON. 187 (1984). By contrast, the concept of 'overinvestment' refers to those situations in which projects with a negative net present value are being financed. *See* Richard A. Brealey, Stewart C. Myers, & Franklin Allen, PRINCIPLES OF CORP. FINANCE 291 (MCGRAW-HILL IRWIN, 4TH ED, 2011).

rejecting value-destroying projects,[41] but they are also incentivizing firms to have inefficient asset structures.

e. *Labor laws*

Some previous studies have shown some correlation between bankruptcy rates and labor laws.[42] Namely, it has been shown that a rigid labor law encourages firms to be more risk-averse due to the higher costs of hiring and firing employees, as well as the lack of flexibility in scenarios of financial trouble. Therefore, rigid labor laws, as Spain has traditionally had,[43] may reduce the risk of insolvency.

IV. ENHANCING THE REGULATORY FRAMEWORK FOR DEBTORS AND CREDITORS IN SPAIN

a. *The need for a structural reform of the Spanish Insolvency Act*

As it has been argued in this paper, the low usage of bankruptcy procedures in Spain may generate several costs. When the risk of bankruptcy is minimized *ex ante,* it may encourage Spanish firms to make suboptimal financial decisions, and it may reduce the level of entrepreneurship and innovation in the country. Likewise, when bankruptcy procedures are avoided *ex post,* once a situation of insolvency already threatens, the typical alternatives to bankruptcy are mechanisms that often destroy going concern value. Therefore, since the pie available for the creditors will be reduced, these alternatives can ultimately lead to an increase in the cost of debt in the country.

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[41] *See* John Armour, Dan Awrey, Paul Davies, Luca Enriques, Jeffrey N. Gordon, Colin Mayer, & Jennifer Payne, PRINCIPLES OF FINANCIAL REGULATION 275, 287 (OXFORD UNIVERSITY PRESS, 2016) (pointing out that the primary function of a bank is to lend money. However, since many other institutions do so, what distinguishes the lending activity of banks is the screening and overseeing the performance of loans). *See also* Douglas W. Diamond, *Financial Intermediation and Delegated Monitoring*, 51 REV. OF ECON. STUD. 393 (1984).

[42] Stijn Claessens & Leora F. Klapper, *Bankruptcy around the World: Explanations of Its Relative Use*, 7 AM. L. & ECON. REV. 253, 275 (2005).

[43] For an overview of the labor regime in Spain and how in the past years, *see* ORG. FOR ECON. COOPERATION AND DEV., THE 2012 LABOUR MARKET REFORM IN SPAIN: A PRELIMINARY ASSESSMENT (2013), http://www.oecd.org/els/emp/SpainLabourMarketReform-Report.pdf.

In my opinion, the Spanish Insolvency Act 2003 reflects a lack of understanding of the economics of bankruptcy and the impact that an insolvency regime may have on people's access to finance, the asset and capital structure of firms, and the promotion of economic growth. For this reason, the Spanish Insolvency Act needs several reforms to enhance the attractiveness of insolvency proceedings for both debtors and creditors.

First, the Spanish Insolvency Act 2003 should implement an *effective discharge* of debts for honest but unfortunate individual debtors.[44] This discharge should certainly be limited to debtors in good faith. However, once a debtor enters into the system, most of their debts should be dischargeable within a short period of time. Thus, bankruptcy law could provide—as it should—a form of insurance for individual debtors in order to favor entrepreneurship, economic growth, and the fresh start of honest but unfortunate debtors.[45]

Second, directors of Spanish companies are subject to one of the world´s harshest liability regimes *toward creditors*. Moreover, the directors of small and medium size firms in Spain are not usually covered by insurance. Therefore, they have even more incentives to be risk averse. For this reason, in addition to encouraging corporate directors to use insurance, the Spanish legislator should soften the *liability regime* of corporate directors existing in bankruptcy. For that purpose, a liability for wrongful trading (as it currently exists in the United Kingdom under section 214 of the Insolvency Act) may constitute a reasonable model to be implemented in Spain.[46]

Third, secured creditors should be allowed to ask for *adequate protection* when they are oversecured – that is, when the value of their

[44] Under Spanish Bankruptcy Law, preferential claims, public claims, and secured debts (among others) are not dischargeable debts. See article 178 bis of the Spanish Insolvency Act. For an analysis of the discharge of debts under Spanish Bankruptcy Law, *see* Fernando Gómez, *La segunda oportunidad del deudor persona individual en Derecho español y el Real Directo-Ley 1/2015*, 40 ACTUALIDAD JURÍDICA URÍA MENÉNDEZ 52 (2015). For a proposal to implement an effective discharge of debts in Spain, *see* Matilde Cuena Casas, *Ley de emprendedores y exoneración de deudas o fresh start*, 31 ANUARIO DE DERECHO CONCURSAL 123 (2014). For an analysis of the fresh start policy in Spain and other jurisdictions, *see* Santiago Senent, *Exoneración del pasivo insatisfecho y concurso de acreedores*, UNIVERSIDAD COMPLUTENSE DE MADRID (2015), http://eprints.sim.ucm.es/28133/1/T35661.pdf.

[45] *See* Kenneth Ayotte, *Bankruptcy and Entrepreneurship: The Value of a Fresh Start*, 23 J.L., ECON. & ORG. 161 (2007); John Armour & Douglas Cumming, *Bankruptcy Law and Entrepreneurship*, 10 AM. L. & ECON. REV. 303 (2008).

[46] For an analysis of this model, *see* Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives, and the Creditors' Bargain*, 59 CAMBRIDGE L.J. 335 (2000); Paul Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency,* 7 EUR. BUS. ORG. L. REV. 301 (2006).

collateral is higher than the value of their claim. Otherwise, they should be allowed to lift the automatic stay unless it is proved that the encumbered assets affected by their collateral: (i) are essential to the primary business of the corporation (as it is provided in the Spanish Insolvency Act 2003); and (ii) are *necessary* for an effective reorganization. If this latter condition is not required, many companies in *economic* distress may use the automatic stay just to opportunistically postpone their liquidation, and value can be destroyed for the creditors. Thereby, secured creditors may respond *ex ante* by increasing the cost of debt to *every* debtor in the market. Moreover, since the lack of adequate protection and the inefficient allocation of the debtor´s assets in bankruptcy may harm the lenders' assets and solvency, they will probably be required by the regulator to register those losses associated with the impairment of their claims. Hence, they will have more incentives to avoid the use of bankruptcy procedures since these losses may harm their financial statements. Therefore, a greater protection to secured creditors in bankruptcy may not only lead to an overall reduction in the cost of debt but it can also make secured lenders less reluctant to use bankruptcy procedures.

Fourth, the lack of a clear *absolute priority rule* in Spanish Insolvency Law also makes creditors more reluctant to the use of bankruptcy procedures. According to the absolute priority rule, senior creditors (e.g., creditors with a higher priority outside of bankruptcy) must be paid first, and only when they have been paid in full (or they have accepted not to be paid in full), junior creditors can get something. Similarly, until junior creditors have not been paid in full, shareholders are *not* allowed to get anything. However, under Spanish Insolvency Law, shareholders can still get something (at the very least, the property of the company´s shares in the reorganized firm), even when some creditors have not been paid in full. This violation of the absolute priority rule may encourage *professional lenders* to increase the cost of debt, and it will make *every creditor* more reluctant to the use of bankruptcy procedures.[47] If the creditors think a

[47] For a seminal work analyzing the *ex-ante* costs of violating the absolute priority rule, *see* Lucian A. Bebchuk, *The Ex Ante Costs of Violating the Absolute Priority Rule,* 57 THE J. OF FIN. 445 (2002). Arguing, however, that a violation of the absolute priority rule may generate some benefits, *see* Lucian A. Bebchuk & Randal Picker, *Bankruptcy Rules, Managerial Entrenchments, and Firm-Specific Human Capital*, LAW & ECONOMICS WORKING PAPER NO 16, UNIVERSITY OF CHICAGO LAW SCHOOL (1993) (arguing that it may encourage investments in non-specific human capital); Douglas Baird, *The Initiation Problem in Bankruptcy*, 11 INT'L REV. OF L. & ECON. 223 (1991) (arguing it may incentivize filing for bankruptcy at a timely manner); Robert Gertner & David Scharfstein, *A Theory of Workouts and the Effects of Reorganization law*, 46 J. OF FIN. 1189 (1991) (arguing that it can discourage excessive risk taking of financially distressed firms); Eli Berkovitch, Ronen Israel & Jaime Zender, *The Design of bankruptcy Law: A Case for Management Bias in Bankruptcy Reorganizations*, J. OF FIN. & QUALITATIVE ANALYSIS 441

deviation of the absolute priority rule can generate value (for example, because the shareholders/managers can keep running the company, and they can add value with their knowledge and experience), they should have incentives to authorize these deviations. Therefore, the hypothetical inefficiencies *ex post* generated by a violation of the absolute priority rule would not even exist. As a result, if the possibility of violating the absolute priority rule may create several costs *ex ante*, and it does not generate any clear gain *ex post*, there are more reasons to be in favor of this rule.

Fifth, unlike other jurisdictions where *unsecured creditors* are protected by either the imposition of a general duty on the trustee to maximize the returns to unsecured creditors, or by the creation of a committee of unsecured creditors funded by the bankruptcy estate, the Spanish Insolvency Act 2003 does not provide any mechanism to effectively protect unsecured creditors. They should just rely on the trustee and its ability to pursue the unclear concept of the 'interest of the bankruptcy procedure'.[48] And if the trustee fails to fulfill its duties and it causes any damage to either the bankruptcy estate (and therefore the creditors as a whole) or to any individual creditor, they are allowed to sue the trustee for damages. In my opinion, the creation of a committee of unsecured creditors may not be needed in those procedures with a low number of unsecured creditors. In these cases, the creation of this committee may do more harm than good. Likewise, a general duty to maximize the returns to unsecured creditors, rather than a duty to maximize the value of the insolvent firm, may sometimes generate perverse incentives to redistribute assets from secured to unsecured creditors, or even to subordinate otherwise unsecured creditors. For that reason, none of these measures should be imposed in the Spanish Insolvency Act 2013 as a *general* rule. However, I think the law should allow the creation of a committee of unsecured creditors funded by the estate in the case of large bankruptcy procedures. Thus, this measure would allow unsecured creditors to have a better level of information about *both* the debtor (e.g., valuation or viability) and the procedure (e.g. stage, costs, trustees). Moreover, since the creation of the committee would not

(1998) (arguing that deviations from the absolute priority rule may help solve the underinvestment problem potentially faced by a financially distressed firm with debt overhang).

[48] For an analysis of this concept, see Ignacio Tirado, *El «interés concursal»: Ensayo de construcción de una teoría sobre la finalidad del procedimiento concursal*, 62 ANUARIO DE DERECHO CIVIL 90 (2009); Aurelio Gurrea Martínez, *Tendencias Actuales en la configuración del interés del concurso*, in Ángel Rojo & Ana Campuzano, ESTUDIOS JURÍDICOS EN MEMORIA DEL PROFESOR EMILIO BELTRÁN: LIBER AMICORUM, 1523–1545 (Tirant lo blanch, Vol. 2, 2015).

be mandatory, it will likely exist only in those cases in which it can be in the interest of unsecured creditors.

Sixth, public creditors enjoy a *preferential status* in the ranking of claims under Spanish Insolvency Law. In my opinion, despite the short-term benefits for the Spanish Treasury created by this statutory priority for public creditors, there are strong arguments for its abolition. On the one hand, it reduces the recoveries of unsecured creditors in bankruptcy. In fact, in some scenarios, this reduction may even trigger the bankruptcy procedure of many unsecured creditors –especially those more exposed to the debtor's bankruptcy. On the other hand, there are no persuasive arguments to favor public creditors over private lenders. In fact, quite the opposite: since public creditors are usually in a better position in terms of information, legal advice and access to finance, it would seem reasonable to improve the position of unsecured creditors with respect to public creditors. Therefore, following the examples of Australia and the United Kingdom,[49] the Spanish Insolvency Act 2003 should *abolish* or, at least, *reduce* the preferential treatment of public claimants in bankruptcy. This would likely best serve the public interest.

Seventh, according to the preface of the Spanish Insolvency Act 2003, the *primary* role of Spanish bankruptcy procedures is to maximize creditors' returns. However, the Spanish legislature does not seem to be consistent with this goal. As it is expressly stated in the preface, reorganization is the 'normal solution' of the single-entry Spanish bankruptcy procedure, and several aspects of the Insolvency Act 2003 support this idea. For instance, the law imposes harsher consequences to the debtor when the procedure ends up in liquidation. Therefore, it incentivizes reorganization over liquidation even if the debtor is not economically viable. Moreover, unless firms state otherwise, the procedure is initiated (and followed) as a reorganization procedure, even if the firm is not economically viable. In my opinion, this preference for reorganization over the liquidation may create several costs.[50] *Ex ante,* it

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[49] The abolition of tax priorities in Australia was proposed in the *Harmer Report* in 1988 and it was implemented in 1997. In the United Kingdom, the *Enterprise Act 2002* removed the Crown priorities traditionally existing in the UK Bankruptcy Law. For an international comparison of tax priorities in bankruptcy, *see* Barbara K. Morgan B, *Should the Sovereign Be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy,* 74 AMERICAN BANKR. L. J. 461 (2000). Explaining the reform of tax priorities in Australia and the United Kingdom, *see* Christopher F. Symes, *Reminiscing thee Taxation Priorities in Insolvency*, 2 J. OF THE AUSTRALASIAN TAX TCHR. ASS'N. 435 (2005); John Duns and John Glover, *The Taxation Priority in Insolvency: An Australian Perspective, 14* INT'L INSOLVENCY REV. 171 (2005).

[50] *See* Aurelio Gurrea Martínez, *La Incomprensible Preferencia del Convenio a la Liquidación Como Solución del Concurso de Acreedores* [The Incomprehensible

will encourage 'lemons' (i.e., economically distressed firms) to *either* try to reach an agreement or to opportunistically postpone the length of the bankruptcy procedure. And if so, value can be destroyed *ex post* at the expense of creditors. Therefore, lenders will have incentive to *both* increase the cost of debt and be more reluctant to the use of bankruptcy procedures. *Ex post,* this preference for reorganization over liquidation may create perverse incentives to try to reach a reorganization plan even in those circumstances in which a company can be worth more in a piecemeal liquidation. For that reason, the Spanish Insolvency Act 2003 should be amended in order to provide a *neutral solution* of the bankruptcy procedure. In my view, the preface of the Spanish Insolvency Act 2003 should mention both solutions as normal way-outs of the procedure, and, depending on the type of problem potentially faced by the debtor (e.g., economic distress or just financial distress), one solution may be preferred over the other. Moreover, both solutions should lead to the *same* consequences for the debtor (or corporate directors) in terms of personal liability.

Eighth, the Spanish Insolvency Act 2003 requires debtors to submit many documents in order to file for bankruptcy (art. 6 LC). However, it misses, in my opinion, the most important one: a *valuation* of the company´s assets as a going concern and in a piecemeal liquidation. This valuation would allow bankruptcy actors to quickly identify those companies in economic distress. The valuation could thereby save those costs associated with postponing the liquidation of non-economically viable companies. Likewise, it can also help identify, in a timely manner, those businesses (or business units) that should be *preserved* as a going concern either as a reorganized firm or through a liquidation/sale of assets. Moreover, since the Spanish Insolvency Act 2003 does not provide different procedures for potentially viable firms that should be reorganized (e.g., the US Chapter 11 or the UK Administration) and potentially non-viable firms that should be liquidated (e.g., the US Chapter 7 or the UK Winding-Up), it will be difficult to distinguish between those firms that deserve to be reorganized and those that do not, at least at an early stage of the procedure. For that reason, and also taking into account that a liquidation implies harsher consequences for the debtor, there will likely be many 'lemons' trying to reach a reorganization agreement. In my opinion, companies *credibly* seeking to be reorganized should submit a valuation of the company´s asset as a going concern and in a piecemeal liquidation as soon as possible. Otherwise, creditors may reasonably believe that the company is under *economic* (rather than just financial)

Preference for the Reorganization over the Liquidation as the 'Way Out' of Spanish Insolvency Proceedings] (Working Paper, 2014).

distress. However, as preparing these valuations can delay the filing, an alternative solution to solve this 'lemon problem' is the implementation of a double (or multiple) entry bankruptcy procedures as it used to exist in Spain before the enactment of the Insolvency Act 2003, and it also exists in most insolvency jurisdictions around the world (e.g., Australia, Singapore, the UK, the US, Brazil, Chile, Colombia, Italy). Thus, by allowing the use of the reorganization procedure *only* to those companies which, in theory, are economically viable and just face financial trouble, the 'lemon problem' would be reduced at an early stage. Nevertheless, as many non-viable firms may still file for the reorganization procedure as a result of many factors (including lack of knowledge about the viability of the business, behavioral factors or even bad faith), some sanctions should be imposed to those debtors seeking reorganization when the company is *clearly* in economic distress.

Ninth, the *costs of filing* for bankruptcy is very high in Spain. In addition to the indirect costs associated with filing for bankruptcy, and the fees charged by both lawyers and accountants, companies have to submit many documents detailing the history, share structure, financial situation, and many other aspects of the company, including financial statements from the past 3 years (art. 6 LC). Moreover, they have to convince the court that they are *unable* to pay their debts as they become due, or, at least, they will become unable to do so in a short period of time (art. 2.3 LC). In my opinion, the requirements in the bankruptcy petition should be reduced,[51] and several arguments seem to suggest the abolition of any financial requirement to file for bankruptcy. First, the proof of financial requirements may delay the petition of an economically viable firm facing financial trouble –especially, when the proof of the insolvency involves judicial control *ex ante*. Second, the existence of bankruptcy costs should reasonably act as a powerful mechanism to constrain debtors' misbehavior in the filing. Therefore, solvent debtors not facing any type of financial trouble should not have incentives to file for bankruptcy. Third, the court may examine *ex post* if there was any 'bankruptcy reason' to justify the filing. If not, some sanctions could be imposed (e.g., liability for damages, litigation costs, etc.). Therefore, there are no convincing reasons to impose a control *ex ante*, especially taking into account that the review of the petition and the commencement of the insolvency proceeding may take months in Spain. As a result, many viable companies may become non-viable during this process, and both viable and non-viable companies may be subject to other costs of financial distress. Thus, value can be destroyed at the expense of creditors, employees, and society as a whole.

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[51] The implementation of a *form* with the most relevant information may be a solution.

Tenth, trustees are appointed at the discretion of the court among a 'qualified' list of candidates. Unlike a system of *randomly* appointed trustees, the current system presents a clear advantage: it allows the appointment of the most qualified professionals for a particular type of debtor. However, the existence of high fees in large bankruptcy procedures may create perverse incentives in the nomination process. In fact, there have been some cases in Spain in which judges have been accused of being directly or indirectly bribed by insolvency practitioners seeking to be nominated in large bankruptcy cases.[52] Therefore, regardless of the truthfulness of these allegations, creditors and debtors might be reluctant to trust the system. For this reason, the current system should be amended in different ways. First, trustees should be subject to higher standards of qualifications and expertise, especially in economics, business and finance.[53] As stated above, a key role of the trustee should be the quick detection of viable or a non-viable firms. And this ability requires a strong background in economics and finance. Therefore, trustees should be highly qualified professionals, and they should prove this level of expertise by passing a *public exam* testing a variety of areas of law, economics, accounting and finance. Second, if all insolvency practitioners are supposed to have a license which requires passing a complex exam and various years of experience, the risk of appointing a non-qualified trustee will be much lower. Third, in exceptional circumstances (for example, in cases involving debtors with very complex businesses), the court should have the discretion to appoint the trustee from among the 'qualified' list of candidates. In these cases, however, the court should be subject to higher standards of justification and disclosure. Finally, the creditors should be allowed to remove the trustee appointed by the court. Thus, not only the creditors - as the primary beneficiaries of the procedures- will be ultimately able to choose the person who is going to manage their interest, but this system will also create better incentives for the judges to appoint

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[52] For a brief video, *see Administradores concursales, bajo sospecha*, LA SEXTA (May 23, 2014), https://www.lasexta.com/programas/equipo-investigacion/noticias/administradores-concursales-sospecha_2014052357264b356584a81fd883f7cf.html. For news stories, *see* Carlos Hernanz, *Investigan a jueces de lo Mercantil por la adjudicación de concursus de acreedores*, EL CONFIDENCIAL (June 7, 2011 at 2:09PM), https://www.elconfidencial.com/empresas/2011-06-07/investigan-a-jueces-de-lo-mercantil-por-la-adjudicacion-de-concursos-de-acreedores_249944/; Jose María Mur, *El juez del caso Banco Madrid se lucró de cursos organizados por el administrador concursal*, IBERCAMPUS.ES (June 1, 2015), https://www.ibercampus.es/el-juez-del-caso-banco-madrid-se-lucro-de-cursos-organizados-30446.htm.

[53] These higher standards of qualification may include the approval of an exam, as it happens in the United Kingdom, or even in Spain for other professions (e.g., auditors).

the most qualified candidates in the exceptional cases of appointing a trustee at the discretion of the court.

Eleventh, Spanish bankruptcy procedures are very *formalistic* and lack the *flexibility* needed to successful manage a bankruptcy procedure. On the one hand, the lack of flexibility in the reorganization plan may hamper the efficient resolution of financial distress. On the other hand, the excessive intervention of both the court and the trustee in the debtor´s operation may increase the length (and therefore costs) of bankruptcy procedures. In my opinion, the intervention of the court should be limited to a very few cases (e.g., approval of the reorganization plan, disqualification of directors, etc.). Indeed, in a system with a court-appointed trustee, this latter actor (rather than the court) should assume, along with the debtor, the main role in the bankruptcy procedure. Otherwise, it would be more desirable to implement a debtor in possession directly supervised (for some relevant decisions) by the court, as it happens in the United States, and several costs would be avoided. In my view, unless otherwise provided by the trustee, the debtor should be allowed to act almost as a debtor in possession, and the trustee should fulfill some of the functions currently played by the court. Thus, by switching part of the functions currently played by the court and the trustee in favor of the trustee and the debtor, respectively, and by increasing the autonomy of debtors and creditors to agree to the terms of the reorganization plan, Spanish bankruptcy procedures could become faster and more efficient.[54] Likewise, by preserving the trustee as a 'gatekeeper' of the debtor´s operation, the risk of opportunism of shareholders vis-à-vis creditors would be lower than in a system of debtor in possession.

Twelfth, while an efficient insolvency framework should make sure that the debtor´s assets are put to their best use, the Spanish Bankruptcy Law does not currently promote this goal. For this reason, various measures should be implemented to achieve the efficient allocation of the debtor´s assets. First, the Spanish Insolvency Act 2003 should implement a *best interest of creditor test* as a way to protect individual creditors from being subject to the imposition of an inefficient reorganization plan. According to this test recognized in §1129(a)(7)) of the US Bankruptcy Code, *any* creditor is allowed to challenge the approval of a reorganization plan when it is shown that an event of liquidation would make the creditor better off.[55] Second, the trustee should have the *duty,* and not just the

[54] Moreover, this reduction in the workload of the bankruptcy court would also be beneficial for other Spanish commercial procedures, since bankruptcy courts in Spain are also in charge of other commercial matters (corporate disputes, intellectual property, commercial contracts, maritime law, etc.).

[55] *See* 11 U.S.C. § 1129. (a)(7)(A)(ii). The US Bankruptcy Code does not mention, however, that the value of the companies should be compared with the value of the

ability,[56] to promote the liquidation of the debtor´s assets when a company´s business has ceased during (or prior to) the bankruptcy procedure. Otherwise, the debtor may have perverse incentives to postpone liquidation, even when, under these circumstances, there might be no chances to turn around the company. Third, the creditors should be allowed to force the liquidation of the debtor´s assets whenever the trustee reveals, normally in its report, that the company is economically inviable.[57] Thus, the creditors could act as additional 'gatekeepers' to prevent, in the interest of society, an inefficient allocation of the debtor´s assets.

Thirteenth, in order to avoid holdout problems and facilitates the quick approval of reorganization plans, Spain should implement a system of *cross-class cramdown* for the approval of reorganization plans. Under this system, imported from the US Chapter 11, the approval of a single class of creditors would be enough to approve a reorganization plan. Once a class approves the plan, this can be imposed on some dissenting classes of creditors, provided that several conditions are met. Among these conditions, the plan cannot discriminate unfairly, and it has to be "fair and equitable." Likewise, as a way to ensure that the plan maximizes the returns to the creditors, the plan should provide the creditors with the ability to challenge the plan if they show that they can be better off in liquidation. Therefore, the best interest of creditor test would also protect individual creditors from the approval of an inefficient plan.

Fourteenth, Spanish Insolvency law allows the avoidance of any *harmful* transactions for the debtor´s assets entered into by a debtor within two years prior to the commencement of the bankruptcy procedure. Moreover, it does not require the proof of any financial requirement to allow the avoidance of the transaction. In my opinion, this system of avoiding powers is very unattractive for legal certainty, since parties – even in good faith- cannot be sure if a transaction that they are entering into may be avoided at some point in the future. As a result, several reforms seem to be needed. First, the underlying rationale of avoidance actions is to prevent (*ex ante*) or to resolve (*ex post*) the misalignment of incentives between a factually insolvent debtor and its creditors, since the latter becomes the residual claimants of the firm but they do not have any control over the debtor´s assets while the company is not yet subject to a

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company in a piecemeal liquidation. Supporting the view of the value of the reorganized firm should be compared with the value of a hypothetical orderly piecemeal liquidation, however, *see In re Crowthers McCall Pattern, Inc.*, 120 B.R. 279, 287 (Bankr. S.D.N.Y.1990).

[56] *See* art. 142 of the Insolvency Act 2003. Before 2011, the trustee did not event have the ability to propose the liquidation when the debtor has ceased in its operations.

[57] This situation will usually take place in firms with negative cash-flows.

bankruptcy procedure. Therefore, a company should be *insolvent* at the moment of *entering into* the transaction. Otherwise, companies should be free to dispose their assets as they wish provided that there is no bad faith. Nevertheless, since the proof of this financial requirement may increase litigation costs, unless otherwise is shown by the debtor or its counterparty, it seems reasonable to assume that the debtor was insolvent within the 'twilight period.' Second, the concept of 'harm' required to avoid a transaction should be clarified. Right now, it is not clear whether it refers to the debtor´s net assets (and therefore the creditors as a whole) or whether it also includes those transactions that may harm the creditors *among* themselves. Finally, I also think the use of avoiding powers should be limited to those situations in which the debtor´s assets are not enough to pay all its creditors, that is, when the debtor is balance-sheet insolvent on a *market* basis. However, since the valuation may differ across time and among experts, I would propose to leave a cushion of assets over the debtor´s liabilities (e.g., 15-20%), as a way to prevent that, in the event of liquidation, the company´s assets may become, at some point, lower than the company´s liabilities. If this financial requirement is not required at the moment of *exercising* the action, the use of avoiding powers would only be beneficial for the shareholders (since the creditors are supposed to be paid in full), and therefore the use of avoiding powers not only can create moral hazard but it can also imply an unjust enrichment for the shareholders at the expense of the debtor´s (potentially good faith) counterparty.

Fifteenth, the old-fashion system of 'labelling' debtors existing in Spanish Insolvency law should be abolished or at least deeply. In my opinion, the existence of this 'label' just contributes to preserve the stigma generally associated with bankruptcy procedures without providing any benefits for the system.[58] *Ex ante,* the existence of this system of labelling debtors may discourage entrepreneurship, responsible risk-taking, the use of debt, and it may make debtors more reluctant to the use of bankruptcy procedures postponing the initiation of insolvency proceedings once it might be too late to reorganize viable but financially distressed companies. *Ex post*, it may hamper the rehabilitation of many honest but unfortunate debtors and corporate directors that just failed to comply with some regulatory provisions. Moreover, the 'label' of a debtor as 'guilty' even

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[58] Proposing the abolition or, alternatively, a structural reform of this historical institution existing in Spanish Bankruptcy Law, *see* Aurelio Gurrea Martínez, *La incomprensible vigencia de la sección de calificación en el Derecho concursal español del siglo XXI* [*The incomprehensible survival of the classification of the insolvency proceeding in the Spanish Insolvency Law of the 21st century*] (Ibero-American Institute for Law and Finance, Working Paper No. 1/2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2710117.

when it is even shown that the situation of insolvency was generated or aggravated *fortuitously,*[59] may even be controversial from the perspective of the debtor´s dignity. For that reason, I propose the abolition or, if so, structural reform of this historical institution traditionally existing in Spanish Insolvency law. This abolition, however, should not imply the lack of sanctions for misbehavior or even fraudulent conducts prior to the commencement of the bankruptcy procedure. In my opinion, these sanctions should be kept, but the imposition of these sanctions does not need any prior 'labelling' process. Besides, they should be imposed during any stage of the bankruptcy procedure and, of course, regardless of the solution potentially achieved by the debtor (reorganization or liquidation). Otherwise, the existence of these sanctions may create perverse incentives to opportunistically design the bankruptcy procedure with the purpose of avoiding these sanctions instead of doing whatever it can be best for the creditors and society as a whole.

b. *Reform of non-bankruptcy laws*

This paper has shown that some non-bankruptcy laws may also affect the risk of insolvency, and therefore the rate of business bankruptcies. First, it has been argued that the creditor-friendly corporate law existing in Spain, and particularly the rules regarding minimum capital and capital maintenance (including the liability of directors to promote the dissolution, restructuring or bankruptcy whenever the company´s assets fall below 50% of the legal capital), may harm innovation, entrepreneurship and access to finance. Moreover, they do not even protect creditors effectively. In my opinion, the minimum legal capital required for private companies should be abolished, at least as a mandatory rule. Instead, if the legislator wants to encourage firms to have more capital, Spain could allow the tax deductibility of an implied cost of equity, as it was implemented with great success in Belgium in 2005.[60]

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[59] For an analysis of this situation, *see* Aurelio Gurrea Martínez, *La Calificación Culpable Del Concurso Por Errores E Incumplimientos Contables* 33–40 (Thomson Reuters, 2016). See also Aurelio Gurrea Martínez, Hacia la supresión de la calificación del concurso, 28 Revista de derecho concursal y paraconcursal 107 (2018).

[60] In a tax reform enacted in 2005, Belgium introduced the possibility of also deducting taxes for the use of equity (*déduction pour capital à risque or intérêts notionnels*). The deduction is based on the concept of "notional interest", which is calculated as an implied cost of equity. For an analysis of this reform and its comparison with other measures and jurisdictions seeking to promote the equal use of debt and equity, *see* Ernesto Zangari, *Addressing the Debt Bias: A Comparison between the Belgian and the Italian ACE Systems*, (Eur. Comm'n Taxation Papers, Paper No. 44-2014, 2014), http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_a

Second, the Spanish legislator should also amend its secured transaction laws to favor the use of non-fixed tangible assets as debt collateral. Thus, not only will it be easier for firms to have access to finance, but this reform will also incentivize firms to choose the asset structure based on what may seem more appropriate for their business model, regardless of how attractive this asset structure may be from the perspective of the lender.

Third, the culture of bank lending in Spain can also generate several costs. Indeed, since lending decisions are primarily based on the ability of the debtor to provide a collateral rather than on the viability of an investment project, various inefficiencies can be created. On the one hand, banks can be financing value-destroying projects. On the other, banks may not be financing value-creating ventures. To minimize these problems, several measures can be implemented. Firstly, Spain should amend its secured transactions laws to promote the use of all types of assets as debt collateral.[61] Secondly, capital requirements for banks should not punish financing debtors that, while unable to provide a collateral, show a high likelihood of success in their investment projects. Likewise, they should not discourage the use of certain collaterals over others, provided that they all have the same quality. Unless these banking rules are amended, banks will still have incentives to request (or over-request) certain collaterals.

Finally, while the Spanish legislator has recently implemented several reforms to make the labor market more flexible,[62] labor laws are still very rigid in Spain. Therefore, the implementation of more flexible labor laws

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nalysis/tax_papers/taxation_paper_44.pdf. For an empirical investigation of the effects of this reform, *see* Frédéric Panier, Francisco Pérez-Gonzáles, & Pablo Villanueva, *Capital Structure and Taxes: What Happens When You (Also) Subsidize Equity*? (2015) (working paper), https://www.bis.org/events/confresearchnetwork1603/perez_gonzalez.pdf. For a general discussion about the impact of the tax benefits of debt on the capital structure of firms, *see* Aurelio Gurrea Martínez, *The impact of the tax benefits of debt on the capital structure of firms and the stability of the financial system,* OXFORD BUS. L. BLOG, (Mar. 30, 2017), https://www.law.ox.ac.uk/business-law-blog/blog/2017/03/impact-tax-benefits-debt-capital-structure-firms-and-stability.

[61] Some steps have been taken at a regulatory level to promote the modernization of the system of secured transactions in Spain. However, many efforts should be still done to modernize the Spanish system of secured transactions in term of both legislation and especially culture. For a further analysis of the situation and the modernization of the law of secured transactions in Spain, *see* Teresa Rodríguez de las Heras Ballell & Jorge Feliu Rey, *Modernization of the Law of Secured Transactions in Spain*, *in* SECURED TRANSACTIONS LAW REFORM: PRINCIPLES, POLICIES & PRACTICES (Louise Gullifer & Orkun Akseli eds., Hart Publishing, 2016).

[62] *See generally* ORG. FOR ECON. COOPERATION AND DEV., THE 2012 LABOUR MARKET REFORM IN SPAIN: A PRELIMINARY ASSESSMENT (2013), http://www.oecd.org/els/emp/SpainLabourMarketReform-Report.pdf (providing an overview of labor reforms that took place in Spain in 2012 and how it made the labor market more flexible).

may help Spanish firms become less risk averse, facilitating innovation, entrepreneurship and competitiveness.

c. Improving the academic and policy debate

The law and finance literature has traditionally focused on the impact that laws and institutions may have on a variety of factors, including investor protection and firms' access to finance. However, they have omitted a factor that, in my opinion, may affect both the law on the books and the quality of the enforcement. In my opinion, this missing gap in the law and finance literature is the role of legal scholars, and more generally the quality of an academic and policy debate in a country.

Firstly, legal scholars have the ability to train future lawyers, judges and other legal actors. Therefore, not only they have the ability to influence their education, but also do they way they face legal problems. Secondly, legal scholars in many countries are involved in policy reforms. This is particularly relevant in Spain, where there is a commission—the *Comisión General de Codificación*—mainly formed by senior legal scholars providing advice to the Ministry of Justice on legal reforms and has been in charge of drafting some laws, including the Spanish Insolvency Act 2003. Thirdly, legal scholars have the ability (or inability) to generate new ideas and policy recommendations that, by improving the legal and institutional framework, can improve people's welfare. Obviously, writing an academic article is not enough for this goal. Nevertheless, if the article is accompanied by a series of initiatives to spread the policy recommendations – for example, through public presentations, blog posts, and other mechanisms– it can make a different, since more people can be aware of these new ideas, and different stakeholders –or even the Government itself- can then push for a legal reform.

However, in order for legal scholars to fulfil these goals in society, they need to be innovative in their legal research and suggest policy recommendations that can improve people's welfare. Unfortunately, legal scholarship in Spain, as in many other countries, is mainly descriptive, just focused on what the law *is* and not on what the law *should* be.[63] So while

[63] Gabriel Doménech-Pascual, *Que innoven ellos: Por qué la ciencia juridica española es tan poco original, creative e innovadora,* 2 Indret (2016); Aurelio Gurrea Martínez, *Implicaciones económicas de la falta de innovación de la academia juridica española,* 72 El Notario del Siglo XXI 64, 64-71 (2017); Aurelio Gurrea Martínez, *The Impact of Legal Scholars on People's Welfare: A Critical Analysis about the Role of Legal Scholars Using the Experience of the Colombian Simplified Stock Corporation as a Paradigm of Legal Innovation*, *in* THE SIMPLIFIED STOCK CORPORATION: INFLUENCE IN LATIN AMERICA, 107–133 (Francisco Reyes Villamizar ed., 2018). This problem, however, does not seem to be

this type of legal scholarship can be very useful for students and practicing lawyers, it can be very harmful to promote legal changes that can ultimately enhance people´s welfare. For that reason, another non-bankruptcy reform potentially suggested to improve the legal and institutional framework in Spain is the promotion of more empirical, interdisciplinary and policy-oriented legal research.

d. Final thoughts: laws vs culture

Even though the reforms suggested in the previous sections may enhance the attractiveness of the legal and institutional framework for debtors and creditors in Spain, it may take time for the business community to absorb the new ideas implemented in a new regulatory framework. Sometimes, the institutional framework may have created a perception or even a "cultural problem". And if that is the case – which is something that this article does not explore- it might take time to get rid of this culture. In any case, amending the regulatory framework is the first step for this change. Then, additional efforts of awareness and capacity building will be needed to make sure that the business community becomes familiar with the principles, philosophy and provisions existing in the new legal framework.

V. CONCLUSION

This article has argued that the low usage of the bankruptcy system in Spain is not due to a cultural problem but to an institutional one. Namely, it has argued that the low rate of business bankruptcies in Spain is better explained by the unattractiveness of the Spanish insolvency system, as well as other legal and institutional factors including a creditor-friendly corporate law, an efficient mortgage system, a rigid labor law, and a poor law of secured transactions. All these factors encourage both debtors and creditors to avoid the use of insolvency proceedings either by minimizing *ex ante* the risk of insolvency or by postponing *ex post* the use of the bankruptcy system once a debtor becomes insolvent. By providing a better understanding of why Spanish debtors might not use the bankruptcy

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exclusive of Spain. In Italy, *see* Luca Amorello & Aurelio Gurrea Martínez, *The Responsibility of Legal Scholars in the Italian Banking Crisis,* Diritto Bancario (March 7, 2017), http://www.dirittobancario.it/approfondimenti/crisi-bancarie/responsibility-legal-scholars-italian-banking-crisis. In France, *see* Sophie Vermeille, Mathieu Kohmann & Mathieu Luinaud, *French Institutions, Innovation, and Growth* (May 9, 2016) (Working Paper), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2760089.

system, this paper seeks to contribute to the general understanding of the use and attractiveness of insolvency proceedings around the world, as well as the economic implications potentially associated with a low usage of bankruptcy procedures.