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Spain
Fernando Colomina, Luis Sánchez
and Aitor Errasti
Latham & Watkins

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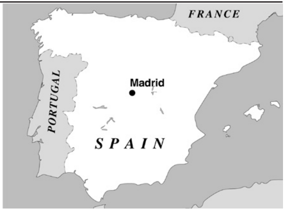

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1. Loan Market Panorama

1.1 Impact of Regulatory Environment and Economic Cycles

Before the negative effects of the COVID-19 pandemic on the global economy, Spain was recovering strongly from the 2008 crisis, which had a great impact in the country. Some actions carried out by the legislators as a consequence of the financial crisis, particularly the strengthening of the Spanish banking system, enabled the economy in Spain to grow faster than that of its neighbours.

In addition to the consequences of COVID-19, certain other risks were also threatening the Spanish economy, such as Brexit, a serious complication of the trade war and internal political instability.

The overall low level of interest rates has enabled traditional loans to be the main source of funding for most Spanish companies. However, the new banking framework resulting from the financial crisis has introduced several measures that have changed the financial structures, including new limits, levels of provision, and controls. Due to these restrictions, banks are becoming more rigid and establishing greater control and supervision requirements over financing. Moreover, new trends such as term loans B (TLBs), high-yield bonds, securitisation as an exit strategy for non-performing loans, and direct lending are a real threat to traditional lending.

Nonetheless, the Spanish legislator has carried out a significant task to promote capital markets as an alternative source of finance. It is fundamental to remember that lending is not a reserved banking activity in Spain. This flexibility has provided an opportunity to new players, including non-traditional lenders, who are becoming a fundamental part in many financing structures.

1.2 Impact of the COVID-19 Pandemic

The debt market has not been immune to the crisis generated by the COVID-19 pandemic, with a series of trends and tendencies affecting the financial condition of companies having emerged since March.

Due to the uncertainty at the beginning of this pandemic, companies' first reaction towards the debt markets was based on maximising the availability of their liquidity, through accessing all financial products available to them. As a result, during the second quarter of 2020, a number of solvent companies have undergone the processes for the utilisation of funds already available and/or committed under the facilities in place.

For those companies where the expansion of the liquidity pool has not been sufficient, there has been recourse to other remedies provided for in the existing facility agreements, with the well-known "waivers" occupying a preferential position. The majority of waivers executed have made reference to the breach of certain financial ratios or debt levels to be reached by the borrowers. In this context, the delay in the approval of companies' financial accounts caused by the lock-down situation is likely to give rise to a delay in the ability to calculate financial covenants and ratios and determining events of default, leading to an increase in waivers.

Many companies in a weaker financial situation have been forced to turn to new ways of financing, particularly those designed by public institutions. At the national level, the Spanish government has made a scheme of guarantees backed by the State available to companies, through the Ministry of Economy and Digital Transformation and the Spanish Official Credit Institute (*Instituto de Crédito Oficial*), designed to facilitate the granting of more than EUR100 billion of financing support to businesses in need of liquidity as a result of the COVID-19 pandemic, through credit institutions, electronic money institutions and payment institutions. Many Spanish companies have taken advantage of this guarantee mechanism.

Given the magnitude of the impact of the pandemic, there have also been a large number of debt restructuring and refinancing transactions, with the pre-pandemic liquidity situation being key in the relationship with creditors in negotiating new arrangements. Only those companies with acceptable cash levels have been able to count on the support of all their creditors, while those in a less favourable situation have had to seek judicial approvals and cram-downs under the so-called "Spanish scheme of arrangement" (*acuerdos de homologación*). The market is expected follow this path, at least in the next few months.

The above trends have also had a heavy toll on deal making and the financing of M&A transactions, where there has been a decline in large LBO transactions in favour of fewer mid-market transactions, leading to a decrease in deal value and volume. Financial safety is the main response to the current situation of uncertainty, resulting in a relocation of resources by companies that have decided to dispense with large financing for expansion purposes in order to channel all the financial resources available to them towards healthier balance sheets.

1.3 The High-Yield Market

High-yield issuance by Spanish groups has been fairly steady over recent years, though there have been some large cap deals. As such, the high-yield market has not played a significant direct role in the emerging trends within the broader banking and finance market in Spain, other than in the very general sense of loan agreements trending towards adopting high-yield incurrence-based covenants.

1.4 Alternative Credit Providers
Although Spanish banks have benefited from Spain's economic recovery, and from easy access to liquidity, traditional banking business is being threatened by increasing regulations, low interest rates, and the emergence of non-traditional lenders.

Since neither a licence nor an authorisation is required to grant loans and credit to companies, debt funds and different types of investment funds are becoming a viable alternative to traditional banks. Generally, these institutions are more flexible and more likely to grant a loan without the borrower having to meet the requirements generally demanded by traditional banks. Additionally, the procedure for obtaining funds from these "shadow banks" can be more flexible than the traditional banks' procedure, so debt funds do not have to comply with all the regulatory and internal formalities required by commercial banks. The flexibility of these new players is based on their business model: the way in which they obtain profitability allows them to lend on a long-term basis, so borrowers are more likely to negotiate bespoke terms, covenants and structures for their loans.

Complex capital structures containing mixes of tranches, including traditional bank loans and institutional tranches, are beginning to emerge.

1.5 Banking and Finance Techniques
Since the financial crisis, companies have grown and invested in new projects, including those related to sustainability and ethical impact. Accordingly, the market has seen the first green bond issuances and other traditional lends with a special attachment to sustainable projects.

In connection with the United Nations' Sustainable Development Goals (SDGs) and other sustainable initiatives, the latest market trends relate to social and environmental projects, and institutional investors are including environmental, social and governance (ESG) criteria in their investment strategies. All of this creates an opportunity for companies to finance their sustainable projects with bond issuances. Traditional bank loans are also starting to link their funding to the company's performance in terms of sustainability.

1.6 Legal, Tax, Regulatory or Other Developments
Prior to the outbreak of the COVID-19 pandemic, the Spanish Parliament was gearing up to start discussing a new Budget Act (which would have included a major tax reform), but COVID-19 forced the Spanish government to focus exclusively on short-term tax measures (eg, stays of collections of taxes for SMEs, stamp duty exemptions for stays of certain mortgage loans granted to individuals). No significant legislative activity in relation to tax measures is likely to take place until a draft Budget Act for 2021 is made public. Royal Legislative Decree 1/2020 was passed on 5 May 2020, by virtue of which the restated insolvency act was approved (the "Spanish Insolvency Act").

2. Authorisation

2.1 Authorisation to Provide Financing to a Company
In terms of general corporate financing, including all transactional financing, no specific authorisations are needed in order to provide financing in Spain, and lenders can provide financing and take leading roles such as security agent or arrangers without obtaining specific permits or authorisations from the Bank of Spain, regardless of whether they are non-financial institutions or registered financial institutions. However, credit institutions acting for the general public (eg, bank deposits) must be duly registered as such, and are required to obtain regulatory licences or authorisations.

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans
As provided in **2.1 Authorisation to Provide Financing to a Company**, there are no general restrictions applicable to foreign lenders.

3.2 Restrictions on Foreign Lenders Granting Security
The granting of an in rem security interest or guarantee to foreign lenders is generally not restricted or impeded.

3.3 Restrictions and Controls on Foreign Currency Exchange
There are no specific restrictions or controls on foreign currency exchange.

3.4 Restrictions on the Borrower's Use of Proceeds
There are no restrictions on the borrower's use of proceeds, as long as such use complies with the applicable laws and the limitations agreed under the relevant debt documents, and the proceeds are not used for illegal acts.

3.5 Agent and Trust Concepts
Typically, an in rem security interest in Spain is granted in favour of all secured parties rather than in favour of the security

agent only, as the concepts of security trustee and parallel debt are not recognised in Spain.

3.6 Loan Transfer Mechanisms

The assignment of rights, such as those under loans, is expressly permitted under the Spanish Civil Code. An in rem security interest governed by Spanish law is ancillary to the main obligation it secures, so the in rem security interest securing a loan is automatically assigned each time the loan is assigned. There are no specific loan transfer or assignment legal requirements, although the assignment of a loan that is secured by a registrable in rem security interest (eg, mortgages, in rem security interest over IP rights, or in rem security interest over machinery) requires certain formalities in order for the collateral to be effective vis-à-vis any third parties, and such formalities may attract stamp duties.

3.7 Debt Buy-Back

Debt buy-back is permitted under Spanish law, but it should be noted that a creditor who acquired a debt up to six months before the application for the declaration of concurso cannot file a petition for the declaration of concurso if the debt was due and payable at the time of acquisition. Please see **7.4 Concept of Equitable Subordination** on potential equitable subordination issues. Any debt bought-back below par may generate some tax issues, which should be analysed in detail.

3.8 Public Acquisition Finance

The financing of a takeover bid must be disclosed in the prospectus, detailing the following:

- the type of guarantees and in rem security interest, their amount, and the identity of the financial entities granting them;
- the sources to finance the takeover bid as well as its main characteristics and conditions, including the identity of the financial creditors and the bidder's forecast to attend the service of the debt in the case of an external financing; and
- the effects of the financing on the target company.

Bank guarantees issued in order to ensure the payment of the cash consideration of the offer in case the bidder fails to pay it are filed with the Spanish market stock regulator (*Comisión Nacional del Mercado de Valores* – CNMV), in favour of the shareholders of the seller.

4. Tax

4.1 Withholding Tax

As a general rule, interest payments made by a Spanish borrower are subject to a 19% tax deduction on account of Corporate Income Tax (CIT) when the lender is a Spanish resident, or Non-Residents' Income Tax (NRIT) when the lender is not a Spanish resident.

Different categories of lenders may be entitled to an interest withholding exemption under Spanish tax law. Interest paid to Spanish banks (or registered branches of foreign banks) and Spanish securitisation funds is exempt from Spanish CIT withholding. Interest payments received by non-Spanish residents may generally be exempt from NRIT withholding if a lender is an EU resident (lending directly or through an EU-based permanent establishment) or a resident in a jurisdiction that has a double tax treaty in force with Spain providing for an exemption on interest payments. Both the EU and the treaty exemptions are subject to the lender demonstrating to the borrower (which has withholding agent status) that it is entitled to the NRIT exemption claimed, through the supply of a valid government-issued tax residence certificate. This certificate should be issued by the tax authorities in the lender's jurisdiction of tax residence during the 12 months prior to the date when the relevant interest payment is due or made. Lenders relying on an exemption based on a double tax treaty provision should ensure that their certificates include a reference to their resident status within the meaning of the applicable treaty.

Interest payable in respect of listed bonds issued by a Spanish issuer may be tax-exempt (regardless of the country of tax residence of the bondholder and the fulfilment of individualised tax certification requirements), pursuant to a special tax regime applicable to qualifying bond offerings. The applicability of such regime should be tested on a case-by-case basis and will be contingent on the fulfilment of certain requirements relating to, among others, the listing venue and the supply of a payment statement certificate by the paying agent to the issuer on a recurring basis.

Payments of principal are not subject to any withholding tax in Spain. Discount gains derived from the receipt of principal (eg, where the loan was acquired at a discount) are not subject to withholding tax but may eventually be subject to Spanish NRIT if the lender is not able to claim an exemption under an applicable double tax treaty.

The withholding tax treatment of fees received by a lender is not addressed under the Spanish NRIT rules, nor by any precedents issued by the Spanish tax authorities. Market participants generally differentiate between fees that may be more akin to interest (eg, a ticking or commitment fee) and fees that may be more similar to service fees (eg, a structuring fee). Service-type fees may be subject to NRIT withholding unless the recipient is able to evidence its entitlement to an exemption pursuant to the provisions of an applicable double tax treaty.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Loans granted to Spanish borrowers are generally exempt from Value Added Tax (VAT), and are not subject to Transfer Tax. The granting of an in rem security interest in respect of a loan is also exempt from VAT and Transfer Tax (provided that the in rem security interest is granted simultaneously with the loan or its execution is foreseen thereunder).

Stamp duty may be levied on security documents that are executed in the form of a public deed (*escritura pública*) in Spain, provided that the public deed granting the in rem security interest is recorded before a Spanish public registry (eg, a land registry, an IP registry, or a movable property registry). An in rem security interest executed by means of a *póliza* deed does not trigger stamp duty. In general, mortgages (over real estate, chattel or IP) require the execution of an *escritura pública* and trigger stamp duty at rates ranging from 0.5% to 2% (depending on the location of the public registry in which the mortgage is eligible to be recorded) of the maximum secured liability under the mortgage.

4.3 Usury Laws

The general principle in Spain with respect to interest is the freedom of contract. However, some laws and regulations have been introduced in order to prevent abusive situations and to protect consumers.

The Spanish Law against Usury, approved in 1908 and known as *Ley Azcárate*, sets out the criteria for a loan to be deemed a "usury loan", and thereby rendered null and void. Other legislation that intends to provide protection for consumers includes Law 7/1998 on general contract conditions, Law 22/2007 on distance marketing of financial services for consumers, Law 16/2011 on consumer credit agreements and Law 5/2019 regulating real estate credit agreements, as well as recent Spanish case law on abusive clauses.

According to the Spanish Law against Usury, any contract that provides for an interest rate that is substantially higher than the normal interest rate and is not proportional to the market conditions and the circumstances of the transaction should be deemed as void. Spanish case law has established that the normal interest rate is determined according to the official statistics registered by the Bank of Spain in relation to the interest rates applied by financial institutions.

5. Guarantees and Security

5.1 Assets and Forms of Security

An extensive variety of assets can typically be given as an in rem security interest under Spanish law, with the most common being shares (in the form of either *acciones* or *participaciones*), bank accounts, real estate and credit rights arising from certain agreements, such as intercompany loan agreements, lease agreements or sale-purchase agreements. Accordingly, the list of assets that can be included in a security package is long and should be negotiated on a case-by-case basis considering the type of transaction, the relevant assets and the agreed security principles, if applicable, which will typically require a cost-benefit analysis when negotiating the security package.

In principle, an asset to be given as security under Spanish law should be located in Spain or, for credit rights, the underlying agreement should be subject to Spanish law, although different positions may be raised. Certain regional laws might be applicable to assets located in certain Spanish regions.

Security interests can take four main forms, depending on the type of asset being charged:

- Mortgages: these are used for real estate assets and movable assets (eg, aircraft, vessels, vehicles, industrial machinery, IP rights or business premises). Mortgages are granted in an *escritura pública* in front of a Spanish notary public and then registered with the competent public registry. They attract stamp duty, which can range from 0.5% to 2% of the maximum secured amount depending on the region where the assets are located. Ship mortgages are an exception, as they are not required to be documented in an *escritura pública*, so stamp duty does not apply.
- Possessory pledges: this is the most common form when granting security over assets that are not subject to a mortgage. Possessory pledges are generally documented by means of a *póliza,* so should not attract stamp duty. As a perfection requirement, the possession of the asset granted as security shall be transferred to the creditor or a third party, which is typically the security agent. For assets that are not physically transferable, certain actions shall be carried out under the pledge agreement that are equivalent to the transfer of possession (eg, delivering notices should be carried).
- Non-possessory pledges: these are distinguished by two main characteristics – the asset subject to the pledge does not need to be delivered to the secured parties, and the pledge should be registered in the competent movable assets registry in order to be perfected. This type of in rem security interest is generally documented in a *póliza* so does not attract stamp duty.

- Promissory mortgages: although these do not create a valid and enforceable in rem security interest creating a direct right over a determined asset nor a privileged/senior claim, they are a commonly used type of quasi-security that avoids stamp duties and gives the beneficiary the right to elevate the promise upon the occurrence of the relevant trigger event agreed between the parties.

All the security documents listed above shall be executed in front of a Spanish public notary, with all parties to the relevant documents appearing with notarised and apostilled powers of attorney. Tax identity numbers and the ultimate beneficial owners must be disclosed to the notary public, unless any exception applies. Notarial fees are calculated based on the amount of the transaction, although they are negotiable when the amount exceeds around EUR6 million. Registrable security documents must be filed with the competent registry, which can deny registration if it considers that the security document as filed has any defect or lacks any required information. Registration costs are standardised and are usually not material.

Finally, it is common practice in Spain for the pledgor, mortgagor or promisor to grant an irrevocable power of attorney in connection with the in rem security interest in favour of the security agent, so that it can perform any required action for the granting, protection, elevation or enforcement of the in rem security interest on behalf of the pledgor or mortgagor if the latter does not meet its obligations under the relevant security document.

5.2 Floating Charges or Other Universal or Similar Security Interests

Floating charges are not recognised under Spanish law, and security must be granted in a single notarial document (either a pledge or mortgage) identifying the concrete asset that is intended to be charged. If there is an amendment to the secured obligations or the pledged/mortgaged asset, the security document should be amended by means of a deed of amendment, extension and/or ratification in front of a Spanish notary public.

5.3 Downstream, Upstream and Cross-Stream Guarantees

As a general principle, the granting of in rem security interests or guarantees by Spanish companies is subject to a corporate interest analysis, which is not expressly regulated under Spanish law; this issue should be analysed on a case-by-case basis.

Recent court rulings have required a direct or indirect tangible benefit for the Spanish obligor when granting in rem security interests or guarantees in favour of any third party. The analysis is highly fact-specific.

Regardless, it is standard and advisable to request both shareholder and board approval when granting an upstream guarantee or in rem security interest.

5.4 Restrictions on Target

One of the key aspects when structuring financing or refinancing transactions with a Spanish component is the impact of the financial assistance prohibition under Spanish law. Spanish companies cannot provide any kind of financial assistance (ie, providing funds or granting loans, guarantees or in rem security interests) for the purposes of acquiring their own shares or the shares of their parent companies (in the case of a *sociedad anónima*, or public limited liability company), with the exception of employees acquiring shares of the company or another company within the group, or financial entities in the ordinary course of their business or any of its group companies (in the case of a *sociedad limitada*, or private limited liability company). Failing to comply with the Spanish financial assistance regulation may result in the in rem security interest or guarantee being declared null and void, and directors may face civil liability claims and potentially even criminal offence charges.

The main objective of this prohibition is to protect the assets of the company from being diluted, and to preserve the interests of shareholders and creditors. To this end, the risk should be lower when there are no minority shareholders or third-party creditors.

Spanish law does not expressly regulate a whitewash procedure, so the prudent position is to consider that these restrictions also apply to a refinancing of debt incurred in connection with an acquisition.

5.5 Other Restrictions

Certain requirements must be met in order to formalise a global real estate mortgage, including that all lenders must be financial entities as defined in Article 2 of Law 2/1981, of 25 March, on the regulation of the mortgage market.

In accordance with Spanish law, the management body of the company is entitled to approve the acts of the company that are part of its corporate purpose.

Shareholders' approval may also be required in *sociedades limitadas*, but not in *sociedades anónimas*, although it may be advisable in order to mitigate the personal liability of the directors (shareholders' approval is advisable, in any case, when granting upstream guarantees or in rem security interests).

5.6 Release of Typical Forms of Security

An in rem security interest under Spanish law is ancillary to the main obligation it secures, so it is automatically released when the secured obligations are repaid in full or discharged in any other way.

However, certain formalities must be completed for the release of an in rem security interest subject to Spanish law. A Spanish deed of release should be executed before a Spanish notary public (and registered when releasing a registered in rem security interest) so that the applicable formalities are carried out.

5.7 Rules Governing the Priority of Competing Security Interests

A Spanish in rem security interest follows the principle of prior in tempore, potior in iure, which means the priority of an in rem security interest over a particular asset is determined by the date on which such in rem security interest was created.

A Spanish in rem security interest can be contractually subordinated, although all affected creditors will need to contractually agree on the stated subordination.

The Spanish insolvency waterfall is mandatory, so contractual subordination provisions may not necessarily be recognised in the case of insolvency, but they would still be binding on the relevant parties, who may rely on the relevant provisions included to that effect in an intercreditor agreement or similar documentation.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

Under Spanish common law, a direct sale or appropriation of charged assets is generally not permitted. Secured parties may be able to enforce an in rem security interest through judicial or extrajudicial proceedings.

Court enforcement proceedings are set out in Article 681 et seq. of Law 1/2000, of 7 January, of Civil Procedure (*Ley 1/2000, de 7 de enero, de Enjuiciamiento Civil*), which foresees a public auction of any type of pledged or mortgaged assets supervised by the court.

The notarial or extrajudicial proceeding offers the secured parties an alternative proceeding based on an out-of-court public auction sale, which takes place under the direct supervision of a Spanish notary public. The parties are given some freedom in deciding the specific formalities of the process, which shall be agreed and further regulated in the security documents. The Spanish Civil Code merely sets out the following general enforcement requirements for pledged shares:

- it must be supervised by a Spanish notary public;
- the sale process must be carried out by means of a public auction, or by multiple public auctions if the first is unattended or unsuccessful;
- notice needs to be given to the debtor and the pledgor; and
- direct appropriation of the assets is not contemplated, unless there is no bidder and the secured parties release the claim in its entirety. However, in the case of pledges over cash, enforcement can be carried out by means of set-off against the outstanding secured obligations and/or by direct appropriation of the cash deposited in the pledged bank accounts, subject to certain requirements.

The notarial proceeding is generally the most typical enforcement proceeding when Royal Decree Law 5/2005 (see below) is not applicable, as it gives the parties flexibility to determine the specific formalities of the process and should be significantly quicker than a court proceeding.

Although Spanish law allows for the execution of mortgages by both judicial and extrajudicial (notarial) means, recent case law seems to suggest that extrajudicial enforcement is not always available, particularly if the debtor is a consumer and the mortgaged property is his or her primary residence.

Royal Decree Law 5/2005, of 11 March, on urgent reforms for the promotion of the productivity and for the improvement of public hiring (*Real Decreto Ley 5/2005, de 11 de marzo, de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública* – RDL 5/2005) implemented the EU Collateral Directive in Spain. It expressly sets out the possibility of the enforcement of certain in rem security interests through a direct sale or direct appropriation upon the occurrence of an enforcement event, and provides for insolvency protection, subject to certain requirements.

RDL 5/2005 recognises the creation of in rem security interests over the following:

- cash – ie, money credited to any account and in any currency;
- negotiable securities or other financial instruments defined in Royal Legislative Decree 4/2015, of 23 October, approving the consolidated text of the Spanish Securities Markets Act (*Real Decreto Legislativo 4/2015, de 23 de octubre, por el que se aprueba el texto refundido de la Ley del Mercado de Valores*), and direct or indirect rights on said securities or financial instruments; and
- credit rights, defined as monetary rights arising from an agreement by which a credit institution undertakes to make a line of credit in the form of a loan or credit available to the other party (excluding consumers and small businesses, with certain exceptions).

However, the scope of RDL 5/2005 is more limited, and its applicability must be determined on a case-by-case basis depending on whether the pledge is created over any of the abovementioned assets and if, among other requirement, (i) none of the parties to the transaction is a natural person, and (ii) at least one of them is a public entity, a central bank, a credit institution, an investment services company, an insurance company, a real estate collective investment undertaking, or any of its management companies, mortgage securitisation funds, asset securitisation funds, or any of the management companies of a securitisation fund, pension fund, or other financial institution, as defined in Article 3 (22) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 or secondary market bodies and management companies of those secondary markets, clearing system companies, entities referred to in Law 41/1999, and equivalent entities operating in the options, futures and derivatives markets.

The main enforcement advantages of RDL 5/2005 for secured parties are direct sale or direct appropriation, the insolvency privileged regime and the absence of formal requirements such as registration, notifications or transfers of possession. The only formality of this type of pledge is that it must be in writing.

6.2 Foreign Law and Jurisdiction

The choice of a foreign law as the governing law of the contract will be upheld by Spanish courts, subject to the terms of Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I Regulation), which shall apply to contractual obligations in civil and commercial matters involving a conflict of laws, regardless of whether or not it is the law of an EU Member State.

The foreign law shall be evidenced to the Spanish courts pursuant to Article 281 of the Spanish Law of Civil Procedure (*Ley 1/2000, de 7 de enero, de Enjuiciamiento Civil*), as amended from time to time, and pursuant to Article 33 of the Law 29/2015, of 30 July, or Law of International Legal Co-operation in Civil Matters (*Ley 29/2015, de 30 de julio, de Cooperación Jurídica Internacional en material civil*).

The choice of a foreign law will not be recognised or upheld by Spanish courts if it is inconsistent with or overridden by the Rome I Regulation, particularly in the following circumstances:

- the application by Spanish courts of the Spanish "overriding mandatory provisions" as defined in Article 9.1 of the Rome I Regulation;
- the effect which, pursuant to Article 9.3 of the Rome I Regulation, may be given by Spanish courts to the "overriding mandatory provisions" of the law of the country where the obligations arising out of a contract must be or have been performed, insofar as those provisions render the performance of the contract unlawful; and
- the potential application by Spanish courts pursuant to Article 12.2 of the Rome I Regulation of the laws of the country in which performance takes place in relation to the manner of performance and the steps to be taken in the event of defective performance.

Foreign law must not be chosen in an attempt to circumvent the application of mandatory provisions of Spanish law. When applying the law of any jurisdiction, Spanish courts may give effect to the mandatory rules of another jurisdiction with which the situation has a close connection if and insofar as those rules must be applied under the law of the latter jurisdiction.

Submission to a foreign jurisdiction is generally upheld by Spanish courts. However, a submission to the jurisdiction of foreign courts that is not recognised may not be valid and binding under the laws of the Kingdom of Spain, and the courts may not accept jurisdiction to determine the matter or may stay or strike out proceedings in certain circumstances, provided that:

- there is some other forum with competent jurisdiction that is more appropriate for the trial of the action;
- the proceedings involving the same cause of action and between the same parties are pending in another jurisdiction;
- the merits of the issues in dispute have already been judicially determined or should have been raised in previous proceedings between the parties; or
- Spanish courts have exclusive jurisdiction.

Spanish courts have exclusive jurisdiction in the following:

- matters relating to the incorporation, validity, nullity and dissolution of companies or legal entities whose domicile is in the territory of the Kingdom of Spain;
- any decisions and resolutions of their corporate bodies;
- the validity or nullity of any recordings with a Spanish registry; and
- the recognition and enforcement in the Kingdom of Spain of any judgment or arbitration award obtained in a foreign country.

A Spanish entity does not generally have a right of immunity from suit, execution or attachment in Spain. However, there is a general principle of Spanish public law that tends to prevent the interruption of the provision of public services, so the assets subject to a public service benefit from special protection against attachment or seizure. The power of disposal over private assets affected to the provision of a public service during the period of affection (*afectación*) is limited.

6.3 A Judgment Given by a Foreign Court

A judgment or arbitral award rendered by a foreign court or an arbitral tribunal is enforceable in Spain if certain conditions are fulfilled. Those conditions vary depending upon whether the judgment is rendered by the court of a Member State bound by EU Regulation 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (*Reglamento (UE) No 1215/2012 del Parlamento Europeo y del Consejo de 12 de diciembre de 2012 relativo a la competencia judicial, el reconocimiento y la ejecución de resoluciones judiciales en materia civil y mercantil*).

A judgment rendered by a court bound by Regulation 1215/2012 would be binding upon and enforceable by Spanish courts without reconsideration of the merits, subject to the following being provided:

- a copy of the judgment that satisfies the conditions necessary to establish its authenticity;
- a certificate issued pursuant to Article 53 of Regulation 1215, certifying that the judgment is enforceable and containing an extract of the judgment and, where appropriate, relevant information on the recoverable costs of the proceedings and the calculation of interest; and
- a translation or transliteration of the contents of this certificate, if required by the competent enforcement court, subject to the grounds of opposition set forth in Regulation 1215/2012 and the Spanish Law of Civil Procedure.

A judgment duly rendered by a foreign court not bound by Regulation 1215/2012 would be enforceable in Spain in accordance with and subject to Article 523 of the Spanish Law of Civil Procedure and the Law on International Legal Co-operation in Civil Matters, which set forth that any final judgment rendered outside the Kingdom of Spain may be enforced in Spain in accordance with the provisions of any applicable treaty, and, in the absence of any such treaty, subject to the provisions and grounds of opposition set forth in the Law on International Legal Co-operation in Civil Matters.

Spanish law provides that the enforcement in Spain of judgments issued by foreign courts is subject to the appropriate order (exequatur) being obtainable, according to the provisions of any applicable international treaty and, in the absence of any such treaty, according to the provisions of the Law on International Legal Co-operation in Civil Matters. The following conditions must also be met:

- the judgment is final and conclusive (*firme*);
- the judgment is not contrary to the Spanish principles of public policy (*orden público*);
- the defendant was duly and timely notified of the proceedings against it and was given the opportunity to defend itself, and due process was observed;
- the subject matter of the judgment must not be a matter over which Spanish courts have exclusive jurisdiction or, with regard to other matters, the jurisdiction of the foreign court is due to a reasonable connection therein, and the choice of law is not fraudulent;
- there is no material contradiction or incompatibility with a judgment rendered or judicial proceedings outstanding in Spain; and
- there is no material contradiction or incompatibility with an earlier judgment rendered in any other State, provided that such judgment complies with the applicable conditions to be enforceable in Spain.

6.4 A Foreign Lender's Ability to Enforce Its Rights

The enforcement of any judgments in Spain involves the following main actions and costs:

- documents in a language other than Spanish are accompanied by a sworn translation into Spanish;
- the payment of certain professional fees required for the verification of the legal authority of a party litigating in Spain (if needed);
- the payment of certain court fees;
- the procedural acts of a party litigating in Spain must be directed by an attorney-at-law, and the party must be represented by a court agent (*procurador*); and
- the content and validity of foreign law must be evidenced to the Spanish courts.

In addition, Spanish civil proceedings rules cannot be amended by agreement of the parties, and such rules will therefore prevail, despite any provision to the contrary in the relevant agreement.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

Ways of making out-of-court settlements under Spanish law include collective refinancing agreements, individual refinancing agreements and court-sanctioned arrangements (known as the "Spanish scheme of arrangement"), which are a kind of collective refinancing agreement.

In a pre-bankruptcy situation, a collective refinancing agreement is a notarised agreement that:

- has the support of creditors holding at least 60% of the debtor's total liabilities;
- extends maturity dates and/or grants new credit and/or amends financial obligations; and
- is based on a business plan that allows business activity to continue in the short and medium term.

An individual refinancing agreement is a notarised agreement that is not supported by most of the creditors, but is protected if it meets the following requirements:

- it improves the ratio of assets over liabilities;
- it ensures that the current assets are no less than the current liabilities; and
- the value of the resulting guarantees is not a greater proportion of the outstanding debt owed to the creditors than it was prior to the refinancing, and does not exceed 90% of the value of the outstanding debt owed to the creditors.

The Spanish scheme of arrangement is a judge-sanctioned collective agreement that has the support of creditors holding at least 51% of the financial liabilities. Its most significant characteristic is that dissenting and abstaining financial creditors can also be crammed-down, subject to certain requirements and limitations, and the affected parties are given greater protection vis-à-vis any claw-back actions that may affect the refinancing.

The communication set out in Article 583 et seq. of the Spanish Insolvency Act enables debtors to postpone the declaration of bankruptcy and block insolvency filings by creditors and, broadly speaking, enforcements. The general rule is that the debtor must file for insolvency within two months of when the debtor's insolvency was or should have been known. This gives the debtor the opportunity to obtain an additional four months, by stating to the court that they are involved in negotiations for a refinancing agreement.

The new Directive (EU) 2019/1023 adopts new tools for implementing preventative restructuring procedures in the EU, in an effort to improve legal certainty for international investors and European companies, and to seek new ways to approach business failure and insolvency in a unified way across the EU. The transposition of the Directive will require the adaptation of the Spanish Insolvency Act. The introduction of one or more efficient early warning tools to detect pre-insolvency situations is essential, as is the novelty of the restructuring practitioners in the preventative framework. Relevant reforms are also required in the actual stay of individual enforcement actions framework, as are new protections for dissenting creditors in terms of a cram-down. Other notable amendments include the distinction of additional classes of affected creditors, the introduction of a treatment for contingent credits, and new benefits for SMEs in the insolvency stage. However, the Directive establishes a minimum harmonisation, granting Member States flexibility in the implementation.

7.2 Impact of Insolvency Processes

Insolvency proceedings prevent the enforcement of the lender's in rem security interest. A declaration of bankruptcy sets an automatic stay of all enforcement actions over the assets of the insolvent debtor that are linked to the general running of the business. This continues until a voluntary creditor's arrangement is approved, the insolvent company is liquidated, or one year passes from the date of the declaration (with some limited exceptions).

Once the borrower is declared insolvent, the next step is the determination of the assets and liabilities. When the debtor has identified its creditors, the bankruptcy judge notifies them of the start of the procedures and their obligation to make their claims under the agreement with the Spanish Insolvency Act. If a creditor's claim is late, its credit can be classified in certain cases as subordinated.

One of the principles that inspires the Spanish Insolvency Act is the equal treatment of creditors (par conditio creditorum), which has few exceptions. Creditors' claims are classified as privileged, ordinary or subordinated, with privileged claims having better treatment than ordinary claims, and ordinary claims having better treatment than subordinated claims, so the order of payment is creditors with privileged claims, creditors with ordinary claims and then creditors with subordinated claims.

7.3 The Order Creditors Are Paid on Insolvency

Before creditors are paid in an insolvency, claims against the entire insolvency estate (*créditos contra la masa*) must be satisfied, including claims that arise from the insolvent company's day-to-day operations, from the date of the declaration of insolvency. The order of payment is basically as follows:

- Claims with special privilege – ie, the credits that are secured, generally by a pledge or mortgage. This privilege covers only the part of the credit that is covered by the value of the security.
- Claims with general privilege, which include salaries and employee compensations (with certain limits), and tax and social security withholdings owed by the insolvent party in compliance with a legal obligation, as well as certain loans involving new cash receipts granted under a refinancing agreement that complies with certain requirements.

- Ordinary claims – these are not classified as privileged or subordinated, but are the remaining unsecured commercial claims.
- Subordinated claims, including claims subordinated by contractual agreement, claims for interest of any kind (except when secured up to the secured amount), and claims for fines and other sanctions. In addition, these are the claims held by creditors that are specially related to the insolvent debtor (managers, directors, shadow directors, partners, or intra-group loans – see **7.4 Concept of Equitable Subordination**).

7.4 Concept of Equitable Subordination

The Spanish Insolvency Act establishes the concept of equitable subordination, with Article 282 et seq setting out that equitable subordination arises when:

- a creditor directly or indirectly holds, at the time the credit rights arise, 5% of the share capital of the debtor (if the debtor is a listed company) or 10% (otherwise);
- the creditor is a company that belongs to the same group of the insolvent debtor and has common shareholders to the extent such shareholders directly or indirectly hold 5% of the share capital of the debtor (if the debtor is a listed company) or 10% (otherwise); and
- the creditor is a legal or de facto director, liquidator or general attorney.

According to the Spanish Insolvency Act, there is a presumption that any entity acquiring a credit from a creditor who is specially related to a debtor is also specially related to such debtor if the acquisition of the credit was effected in the two years prior to the declaration of insolvency, unless evidence is provided to the contrary.

7.5 Risk Areas for Lenders

Lenders must be aware of potential issues that can affect their situation if the borrower become insolvent, with the most common risks being as follows:

- A two-year claw-back period is established under Article 226 et seq. of the Spanish Insolvency Act, by virtue of which any act or agreement that is deemed to be detrimental to the debtor's estate in the two years prior to the declaration of insolvency will be null and void, even if there was no wilful or fraudulent intention. The article differentiates between acts/transactions that are automatically presumed as detrimental, and acts/transactions that admit evidence. Generally, automatically presumed detrimental acts are liberalities, and those that admit evidence are onerous. However, Article 598 et seq. of the Spanish Insolvency Act sets out exceptions to the claw-back period for agreements entered into at a refinancing stage that extend the credit in a significant amount or modify some terms of the agreement for the debtor's benefit, as well as all the ordinary transactions of the insolvent company's business activity.
- In order to have access to the most efficient enforcement proceeding, the documents by virtue of which the secured obligation is created must be notarised as public documents.
- Under Spanish law, not all events of default listed in a loan agreement will be admissible for enforcement.
- As a civil code jurisdiction, Spanish courts have a more subjective approach to interpretation, which could result in the court interfering with contractual rights if deemed appropriate to do so.
- The application of Article 583 et seq. of the Spanish Insolvency Act may have an important impact for lenders. If the borrower makes the communication established in the article above, judicial or extrajudicial enforcements of rights or assets that are necessary for the continuity of the debtor's business activity cannot be initiated, and any enforcement proceeding will be suspended.

8. Project Finance

8.1 Introduction to Project Finance

Spain has historically been active on project finance, but the outbreak of the financial crisis severely affected project finance transactions and froze some estate plans, including the Extraordinary Plan for Roads (*Plan Extraordinario de Inversiones en Carreteras*), which has suffered a significant delay due to political instability and bankruptcy among the traditional concessionaires. Today the situation in terms of acceding to financings is different; there is more liquidity in the banking and finance market, which has led to a revival of the project finance market, and infrastructure funds continue to gather market share on both the equity and the lending sides.

Likewise, the sustained growth of the Spanish economy has made it possible to continue with investments in different projects, notably in the renewable energy sector. However, observers must be aware of the Spanish political instability, which has caused problems in the regulatory field and public investment.

Finally, there has been a consolidated trend in recent years towards the refinancing of brownfield projects by the issuance of project bonds instead of the traditional banking refinancing.

8.2 Overview of Public-Private Partnership Transactions

There is no explicit legislation for public-private partnership (PPP) transactions, but the Spanish Public Sector Contracts Act sets forth a broad regulation on PPPs relating to matters such as termination provisions, faculties of the public administration, rights and duties of the contractors, etc.

PPP structures have been used in Spain for different types of infrastructure, notably transportation (railways, ports, airports, subways, etc) and social services (universities, penitentiaries and clinics).

As a decentralised country, Spain does not have a centralised PPP public authority, so PPP operations can be launched by central, autonomous or municipality public bodies.

8.3 Government Approvals, Taxes, Fees or Other Charges

In general terms, a project finance transaction is not subject to governmental authority; however, sectorial authorisations may be requested in some sectors, especially energy.

Following Spanish regulations and the harmonisation of the EU Directives, project finance transactions are subject to not only the approval of the applicable Spanish institutions depending on the characteristics of the project, but also the payment of the relevant taxes, based on the construction of infrastructure and the use of the land. The amount charged will vary depending on the extension – in terms of time – of the use of the land.

Additional royalties must be paid to local institutions; these taxes vary between regions.

8.4 The Responsible Government Body

The responsible government body depends on the sector in which the project finance transaction will be carried out.

The main government body responsible for granting the relevant authorisations for exploration, investigation and exploitation in the field of oil and gas is the Ministry for the Ecological Transition (*Ministerio para la Transición Ecológica y el Reto Demográfico*). The main regulation that governs the oil and gas sector is Act 34/1998, of 7 October, on the Hydrocarbons Sector (Hydrocarbons Act), as amended. The gas market has undergone several changes in recent years, specifically with regard to the remuneration framework for regulated gas activities (gas distribution, transmission, regasification, and storage activities) that was approved by the Spanish government by means of Royal Decree-Law 8/2014 of 4 July (RDL 8/2014), which approved urgent measures to encourage growth, competitiveness and efficiency. This regulation was incorporated definitively into the Spanish legal system through the enactment of Act 18/2014, of 15 October (Act 18/2014), which included commercial deregulation measures and established an energy efficiency system in line with EU Directives. On 21 May 2015, Act 8/2015 was enacted, amending the Hydrocarbons Act and establishing certain tax and non-tax measures for the exploration, research and exploitation of hydrocarbons.

The Ministry for the Ecological Transition is also responsible for the authorisation of projects in the field of electricity. The Electricity Sector Act 24/2013, of 26 December (Electricity Act 24/2013), is the main regulation in the electricity sector, and amends the remuneration scheme that existed under the now repealed Electricity Act of 1997. The regulation on renewable energy electricity generation activity – Royal Decree 413/2014, of 6 June (RD 413/2014) – regulates electricity generation activity using renewable energy sources, cogeneration and waste.

Royal Decree-Law 23/2020 entered into force on 25 June 2020, approving new measures in the energy sector that aim to promote renewable energy generation and support the recovery of the economy in line with the European Green Deal (the New Regulations).

According to the Spanish Energy Plan, new renewable energy generation facilities with an installed capacity of approximately 60,000 MW will be built this decade, with an estimated investment of more than EUR90 billion. A new remuneration framework based on the long-term recognition of a fixed price for the sale of electricity produced by renewable facilities is approved. The regulated remuneration will be awarded through competitive tendering processes whereby the product to be auctioned will be the electricity, the installed power capacity, or a combination of both.

Royal Decree 1955/2000 of 1 December, as amended by the Electricity Act 24/2013, regulates the regime applicable to transportation, distribution, commercialisation and supply activities. The management of transportation, as a regulated activity, is entrusted to Red Eléctrica de España, which is also the system operator.

Finally, the General Directorate of Mining of the Ministry for the Ecological Transition is the government body responsible for granting authorisations in the field of mining. The mining sector is mainly governed by Act 22/1973, of 21 July, on Mining and by Royal Decree 2857/1978, of 25 August, approving the general regulation for the mining sector.

Regional governments also have competences concerning oil and gas, electricity generation, and mining within their territory.

8.5 The Main Issues When Structuring Deals

There are different challenges to face when structuring a project finance deal, with the following being the most common:

- Control of cash flow: the key factor in project finance is the generation of cash flow (its predictability and certainty), for the debtor to cover the debt service and repay the principal. Banks will always try to have severe control over the cash flow, unlike the debtor, which prefers to have the freedom to be able to dispose of cash flows. A common structure for the protection of cash flows is as follows:
  (a) funds are deposited in a restricted account, pledged in favour of the debt providers;
  (b) essential costs and expenses for the project and the operational expenses of the project are the first to be paid;
  (c) the interest and commissions of the finance are paid next. If there is a hedging agreement, the costs of hedging must also be paid; and
  (d) if the payment of amortisations has not been stipulated, the remainder may be freely disposable.
- Security package: project finance operations present certain peculiarities in the structuring of the security package. Taking into account the exposure of the lenders to the success of the project, it is key that creditors receive a robust collateral package that extends to each of the debtor's essential assets. For this reason, there is usually a requirement for a support contract of partners and a set of pledges of all kinds, including:
  (a) on the company's shares;
  (b) over the various project accounts; and
  (c) on the credit rights arising from all contracts relating to the project.

8.6 Typical Financing Sources and Structures for Project Financings

The typical structure of a project finance deal is based on a Special Purpose Vehicle (SPV) incorporated by a pool of investors. The aim of this structure is to limit access for the lender to the project's income, so that it is non-recourse or limited-recourse to the patrimony of the promoters. The SPV receives the funds and executes the project directly or through its subsidiaries, with limited development for other activities.

Unlike other traditional forms of finance, the financial solvency of the debtor is not fundamental. However, lenders must rely mainly on the future capacity of the project to generate the necessary cash flow to meet the payment obligations. In order to achieve this, it is essential to carry out an exhaustive study and review of all the risks of the project.

For a successful project, it is necessary to impose a series of strict covenants related to continuous information on the status of the project. As such, in project finance, covenants are a fundamental part of the agreement.

8.7 The Acquisition and Export of Natural Resources

Due to Spain's lack of the main natural resources, this is not the most active sector for project finance.

8.8 Environmental, Health and Safety Laws

Project finance transactions have a significant environmental impact so are generally subject to the granting of integrated environmental authorisations as required by Royal Legislative Decree, of 16 December, approving the consolidated text regulating integrated pollution prevention and control. Regional governments are responsible for granting authorisations in autonomous regions that have enacted their own acts for integrated pollution prevention and control.

The basic regulation in Spain regarding potential soil and groundwater contamination is Law 22/2011, of 28 July, on Waste and Contaminated Soils (Regulation on Waste and Contaminated Soils); some autonomous regions have also passed regulations. Pursuant to the Regulation on Waste and Contaminated Soils, each autonomous region shall maintain a list of contaminated land. Moreover, Royal Decree 9/2005, of 14 January, establishes a list of potentially contaminating activities and the criteria and standards for the declaration of polluted soils. The owners of land where potentially soil-contaminating activities have been performed should disclose such fact in a public deed if there is a transfer. Under Spanish law, if soil is declared contaminated, those persons held liable for said contamination would be compelled to put the necessary remediation measures in place. In this regard, the principle of "polluter pays" applies to soil and groundwater contamination, so the persons potentially liable are the polluter or polluters, or the property owners and those in possession. The persons held liable (others than the polluter) could seek to pass on remediation costs to the polluter or polluters.

The water regime is set forth in Legislative Royal Decree 1/2001, of 20 July, approving the Spanish Water Law, which seeks to ensure the protection of the hydraulic public domain. According to the regime, any activity related to the discharge of water that could pollute or degrade public waters requires the correspondent administrative authorisation.

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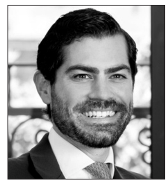

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