

THE ACQUISITION
AND LEVERAGED
FINANCE REVIEW

NINTH EDITION

Editor
Fernando Colomina

THE LAWREVIEWS

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PREFACE

Market conditions have remained challenging through the past year. The post-pandemic recovery globally saw a significant setback as a result of the war in Ukraine, which exacerbated the pre-existing market issues and led to historic policy actions and moves across global markets. US inflation saw a cool-down from a second-quarter peak as the Fed turned to aggressive tightening on the market, risking triggering a recession in the US economy. Eurozone inflation accelerated through the year, reaching record double digits in the third quarter as power suppliers looked for alternative sources amidst soaring energy prices. Governments have been forced to intervene, with energy price caps announced to protect households through the winter. Further rate rises will be expected at European Central Bank policy meetings to tame inflation and restore price stability as recession risks grow.

In tandem with these challenges, the acquisition and leveraged finance industry saw primary issuance slow down significantly, with declines of almost 50 per cent in the first half of the year from record highs in the same period in 2021. Market conditions particularly deteriorated throughout the second quarter as we saw the credit markets take an early summer break. One bright spot, accounting for the largest portion of European buyout activity, was the volume of add-ons in popular defensive sectors such as B2B and IT, as financial sponsors looked to build up portfolio companies through the uncertainty.

Traditional lenders have been cautious about underwriting buyouts in this environment as spreads have widened. Financial sponsors across Europe have consequently considered private debt funds as a viable alternative to the syndicated markets. This year, they have played a more prominent role in larger buyout financings across sectors, with several funds sharing the risk. There are, however, signs that private debt funds are becoming more selective and looking to safer sectors that are less cyclical and protected from supply-chain issues. We would expect to see an increase in pricing on financing packages with less leverage and a demand in stronger protection and more-conservative terms.

As we enter 2023, macroeconomic conditions in Europe in a tighter policy environment are likely to remain challenging in the first half of the year. There will be an increase in liability management transactions, restructurings and distress-related M&A across more cyclical, capital-intensive sectors and highly indebted buyouts. But down markets and recessions provide good buying opportunities. With European equity prices likely to remain at relatively low and attractive levels, take-private transactions will continue to be an attractive source of deal flow. The strengthening US dollar also creates an opportunity for financial sponsors to take advantage of an attractive FX rate, particularly if the businesses are resistant to inflation or provide counter-cyclical business hedges.

Many thanks to everybody who has participated in this publication, and a special thank you to Law Business Research.

We sincerely hope that this edition of *The Acquisition and Leveraged Finance Review* will be of assistance to you in this challenging era.

Fernando Colomina

Latham & Watkins

Madrid

November 2022

SPAIN

Fernando Colomina, Iván Rabanillo, Luis Sánchez, José María Alonso and Aitor Errasti¹

I OVERVIEW

In 2021 the world commenced a gradual recovery in both the health and economic sectors. Global GDP grew around 6 per cent, very strongly compared with a 3.2 per cent contraction in 2020. Although Spain's GDP growth was very similar to the world average, 5.6 per cent, the contraction in the previous year was much deeper, up to 10.8 per cent, mainly due to the Spanish dependence on the international tourism. Moreover, its public sector has not been able to turn the public deficit, which increased to 6.76 per cent of GDP in 2021, amounting to almost 120 per cent of GDP by the end of 2021. The interest rate rise commenced by the end of the year anticipates potential monetary tensions in the near future.

On top of the rise in the interest rate, inflation is the main economic challenge that the Spanish economy will be facing. On the political side, the usual instability due to a weak coalition government will be complemented with instability in other EU countries and proximity to general elections, which may put the government's focus on the short term.

In this all uncertainty, private capital and hedge funds recorded another very successful year. Investments, exits and fundraising were all very prosperous across private equity and private debt. This activity confirmed a very high level of resilience in 2020, during the most difficult period of the covid-19 crisis, and one year later proved a high ability to adjust and take advantage of a rapidly changing context. Private capital has been very successful in the past decade thanks to historically low interest rates. Thanks to this background, fundraising finished 2021 at near record figures: US\$191.2 billion, 12.1 per cent above the previous year and the second best year in history. Direct lending appears as the new kid on the block on the European private debt market, which has been later out of the gate than in the US. However, this new trend is most likely to become more than an outsider on the old continent and particularly in Spain. A heavily regulated, less risk-tolerant and more formalistic banking sector will definitely give up market share.

The attention on ESG, and in particular on sustainability, continues to be one of the mainstays of the market. The new ESG regulations, including the first stage of the EU's taxonomy for sustainable activities, confirm this new economic trend. We believe this is a one-way ticket.

¹ Fernando Colomina and Iván Rabanillo are partners, Luis Sánchez and José María Alonso are counsel and Aitor Errasti is an associate at Latham & Watkins.

Spain should take advantage of the over €31,000 million of EU recovery funds that have already been secured, in order to fuel and relaunch its economy. However, the government is taking longer than expected to process those measures and the market's feeling is that those are still far from having a real impact on Spain's domestic economy.

Taking advantage of other measures approved in order to compensate the economic and social impact of covid-19, the Spanish government imposed certain restrictions on foreign investments in Spain, which are further described in this chapter.

Finally, the new Insolvency Act, which has been expected since Directive 2019/1023/EU of the European Parliament and of the Council, which had to be transposed in Spain, was recently approved. It is still unknown how successful the more sophisticated and flexible measures, in particular the newly created pre-insolvency institutions, will become and, specially, if the mercantile courts will play an active role in this new game. In any case, this is a good starting point and it is exciting to have it in place now, as a wave of restructuring transactions and eventually insolvency proceedings will arise.

II REGULATORY AND TAX MATTERS

i General regulatory requirements

Generally speaking, no regulatory permits or authorisations are required to act as a lender or a security agent in acquisition finance deals in Spain, although certain regulatory authorisations and registrations may be required to act as a credit entity for consumers.

ii Sanctions and anti-money laundering

Sanctions

As a member of the European Union (EU) and United Nations (UN), Spain follows the sanctions imposed by the Security Council of the UN and by the EU authorities under the Common Foreign and Security Policy.

AML regulations

Anti-money-laundering (AML) regulations in Spain require that, prior to initiating any business relationship, the ultimate beneficial owner (UBO) of the parties involved in the deal must be clearly identified.

For legal entities, the UBO is defined, in simplified terms, as the natural person who ultimately owns or controls, directly or indirectly, more than 25 per cent of the share capital or voting rights of the legal person, or who by other means controls, directly or indirectly, the management of a legal person.

In the event that a particular legal entity has no UBO (as defined above), the Spanish anti-money laundering laws presume that the control is exercised by the directors, and therefore, their personal details should be disclosed. In the event that a director is a legal person, the personal details of its representatives (or directors) should be disclosed.

These requirements are of particular significance in Spain because, while notarisation of a loan document is not required by law, notarisation affords the lenders material enforcement advantages; as such, it is market practice to do so. In addition, as a general rule Spanish security interests must be notarised; in any case, it is again market practice to do so. A notary may refuse to grant the relevant deed if there is any failure to satisfy these UBO requirements.

iii Regulations of foreign investments in Spain

Act 19/2003, of 4 July, on the legal framework of capital movements and foreign economic transactions (Act 19/2003) and its associated regulations establish the regime for foreign direct investment (FDI) in Spanish companies.

Traditionally, Spain's FDI regime only applied in relation to investments directly related to Spanish national defence. However, in March 2020, within the covid-19-related measures adopted by the Spanish government, Act 19/2003 was amended to include a broader FDI screening regime (Article 7-bis).

Pursuant to Article 7-bis, transactions over €1 million that allow the foreign investor to directly or indirectly (1) reach ownership of 10 per cent or more of the shares of a Spanish company or (2) attain control of the Spanish company as understood under antitrust regulations, may require prior authorisation. This prior authorisation is required only if:

- a* the target carries out activities that may affect public order, public security or public health in certain sectors that are considered strategic (strategic sectors); or
- b* regardless of the sector of the target, the foreign investor meets certain characteristics (qualified investors).

Foreign investors include (1) investors resident outside the European Union (EU) and the European Free Trade Association (EFTA) and (2) investors resident in the EU or EFTA whose UBO is a non-EU or non-EFTA investor. Ownership by the UBO is understood to exist if it holds, directly or indirectly, a stake above 25 per cent of the share capital or voting rights of the company making the investment, or when the UBO exercises control by any other means.

Transitorily, and until 31 December 2022, the regime has been extended to investments carried out in the strategic sectors by investors resident in the EU or EFTA provided that (1) the Spanish target is listed in a Spanish official secondary market (regardless of the value of the transaction) or (2) if it is a non-listed Spanish target company, to the extent that the value of the transaction is greater than €500 million.

Strategic sectors include:

- a* critical infrastructure (physical or virtual);
- b* critical technology and dual-use products and key technologies for industrial leadership and training and technologies developed under projects or programs which are of particular interest to Spain;
- c* supply of critical inputs, in particular energy, fossil fuels, raw materials, as well as food supply and strategic connectivity services;
- d* sensitive information, including access or control of personal data under the General Data Protection Regulation (EU) No. 2016/679; and
- e* media.

Qualified investors are those who:

- a* are directly or indirectly controlled by a government, including state bodies, sovereign funds or armed forces, of a third country;
- b* have made an investment or have already been involved in activities affecting security or public order in a EU member state and in particular in the sectors listed above; or
- c* pose a risk of carrying out criminal or illegal activities affecting public order, public security or public health.

The review period for the authorisation is six months, unless the value of the investment is below €5 million, in which case the review period is 30 business days. Where the acquisition is not politically sensitive, these authorisations are generally provided as a matter of course and in two to four months from the date of filing.

Investments carried out without the required authorisation will be considered invalid and with no legal effect in Spain, pending clearance. Additionally, the foreign investor may be fined. The sanction may reach the full value of the transaction.

While FDI approval is principally a matter of concern from an M&A perspective, it is also relevant in a debt finance context as this approval may be required to enforce security documents granted directly or indirectly over the shares of Spanish companies.

iv Tax matters

Deductibility of interest

Spanish corporate income tax (CIT) law does not provide for a thin capitalisation regime, but has an interest-stripping regime limiting the deductibility of net interest expenses to 30 per cent of adjusted operating profits (roughly speaking, earnings before interest, taxes, depreciation and amortisation (EBITDA)) in a given fiscal year, with a €1 million floor. The excess difference could benefit from a carry-over for an indefinite period of time. Where a taxpayer incurs net interest expenses not exceeding this €1 million floor, the difference between such interest cost and the floor amount will increase the applicable 'cap room' in the five subsequent years. These rules must be tested at a group level where the Spanish borrower belongs to a Spanish fiscal unity (subject to the anti-leveraged buyout (LBO) rules described below).

The existence of a Spanish fiscal unity could have certain advantages. In general, a leveraged holding company may be able to shelter taxable income obtained by its subsidiaries belonging to the Spanish fiscal unity against interest expenses incurred at the holding company level. Furthermore, dividends received by such a holding company from its qualifying subsidiaries not belonging to the fiscal unity² (to the extent they benefit from the Spanish participation exemption regime)³ would be treated as additional EBITDA for purposes of the interest-stripping regime.

The Spanish interest-stripping rules are generally in line with the conclusions of Action 4 of the Base Erosion and Profit Shifting initiative⁴ and deemed to be 'equally effective'

2 For instance, non-Spanish resident subsidiaries, or Spanish-resident subsidiaries that do not meet the requirements to belong to a fiscal unity (in general, a 75 per cent participation in the share capital – 70 per cent if the subsidiary is a listed company – and majority of the voting rights).

3 Roughly speaking, the exemption applies where a Spanish parent company holds a direct or indirect stake of at least 5 per cent (or having an acquisition cost of at least €20 million) in a Spanish or foreign subsidiary, held for a minimum one-year holding period. Foreign subsidiaries must also meet a 'subject-to-tax' test. Certain limitations apply where, for example, the subsidiary is a holding company or where it is deemed to be an 'asset-holding' company. The participation exemption does not provide for a full exemption of Spanish CIT on qualifying dividends and capital gains, but rather, an amount equivalent to 5 per cent of such amounts is deemed to correspond to non-deductible portfolio management expenses. Consequently, only 95 per cent of such amounts would be tax-exempt. Since the Spanish CIT rate is generally 25 per cent, the effective taxation of such amounts should be in principle 1.25 per cent (5 per cent x 25 per cent CIT). However, this 1.25 per cent CIT may be reduced or eliminated should the taxpayer have other deductible expenses that may be used to offset such tax.

4 Sponsored by the OECD and sanctioned by the G20.

in comparison with the interest limitation rule provided under the EU Anti-tax Avoidance Directive adopted by the Council of the European Union in July 2016. At this stage, no significant amendments to the Spanish rules outlined above have yet been announced, but many foreseeable changes that may take place in the interest-stripping rules to reflect the Directive's contents⁵ (in principle, prior to 1 January 2024) do not deviate significantly from the current regime (except for the expected derogation of the rule allowing adding exempt dividends to the EBITDA threshold).

On the other hand, there are certain anti-abuse rules that may limit the availability of interest deductions within a fiscal unity or upon a post-acquisition merger. For instance, an 'anti-LBO' rule imposes an additional limitation to the deductibility of interest accruing on debt incurred to make acquisitions of shares.⁶ Under this rule, where the bidco vehicle and the target company merge or form a fiscal unity in the four years following the acquisition, the above-mentioned 30 per cent EBITDA limitation should be tested taking into account only bidco's standalone EBITDA and not the fiscal unity's (or the EBITDA corresponding to the merged entity, as the case may be). To the extent that bidco is a special-purpose vehicle set up for purposes of performing the shares acquisition (and not an operating entity), this rule would, in practice, prevent that acquisition interest was tax deductible.

To dispel allegations that the anti-LBO rule put private equity firms at a disadvantage as regards industrial groups, the Spanish lawmaker introduced an 'escape clause' to the anti-LBO rule, whereby the additional 30 per cent limitation would not apply if: (1) the level of leverage does not exceed 70 per cent of the purchase price of the shares acquired; and (2) such acquisition debt is reduced on a proportionate basis within the eight years following the acquisition, until the debt reaches a threshold of 30 per cent of the purchase price.⁷ Where the acquisition is financed through different kinds of loan facilities (e.g., junior, senior, mezzanine, vendor loans or other types of loans), the amortisation required under the anti-LBO rule may be performed in any of such facilities, provided that the combined

5 For example, an increase of the minimum interest deductibility floor up to €3 million, the introduction of safe harbours to public infrastructure financing projects and the introduction of a consolidated group ratio rule.

6 Regulated financial institutions and insurance companies (and their holding companies, to the extent they are subject to the oversight of the financial or insurance regulators) may not be subject to the interest-stripping rules and the anti-LBO rule.

7 The Spanish tax authorities, in binding tax ruling V1664-15, dated 28 May 2015, have addressed certain queries made by a private equity firms association regarding the practical applicability of the anti-LBO rule. As per the tax authorities, the fulfilment of the second requirement should be tested on an annual basis, by comparing the level of indebtedness of the bidco at the end of each fiscal year with the acquisition debt. Even if the acquisition debt accounted for less than 70 per cent of the purchase price, its principal amount should be nevertheless reduced proportionally on annual basis over such eight-year period until it reaches 30 per cent. Nonetheless, if in a given year the acquisition debt is reduced at an amount exceeding the minimum amount required to be amortised as per the amortisation schedule of the anti-LBO rule, the taxpayer may not be required to reduce it further in subsequent years until the remainder of the debt catches up with the amortisation schedule.

outstanding principal amount of all of them does not exceed the maximum threshold for the year in question.⁸ On the other hand, the indebtedness existing at the target company prior to its acquisition does not appear to fall under the scope of this rule.⁹

In addition, there are other anti-abuse rules under Spanish tax law that may limit the deductibility of interest incurred by a Spanish borrower. Interest expenses arising in connection with intragroup debt, where that debt is used to acquire shareholdings from other group entities or to perform equity contributions into other group entities are non-deductible, unless the borrower is able to evidence to the Spanish tax authorities that there are sound business reasons for the transactions.¹⁰ Furthermore, interest accruing on profit-participating loans (PPLs) granted by group entities, and interest giving rise to hybrid mismatches,¹¹ are also non-deductible. Spanish transfer-pricing rules may also be used by the Spanish tax authorities to challenge interest deductibility in a related-party loan and to

8 See binding tax ruling V1664-15. The failure to meet the mandatory amortisation requirements in a given fiscal year does not jeopardise the taxpayer's ability to deduct interest on the debt in future fiscal years, provided that the taxpayer catches up with the amortisation schedule in such subsequent years.

9 In the context of LBOs, it may be possible to refinance existing acquisition debt deemed to be 'tainted' by operation of the anti-LBO rules without running afoul of the anti-LBO rules, although this possibility should be analysed on a case-by-case basis and bearing in mind the legal ramifications of such refinancing as well. In binding tax ruling V4487-16, dated 18 October 2016, the Spanish Tax Authorities have concluded that the swapping of tainted acquisition debt by refinancing debt used to finance a 'dividend recap' distribution to shareholders might, in some circumstances, not be tainted for purposes of the anti-LBO rules.

10 In that regard, there are good grounds to defend (as per the criterion set forth by the Spanish tax authorities in certain binding tax rulings – such as V0775-15, dated 10 March 2015), that there are 'sound business reasons' where the leveraged intragroup acquisition is performed in a connection with a post-acquisition debt push-down plan (e.g., following the acquisition of a multinational group, partly financed with bank debt, the purchaser group sets up a structure that would allow a portion of such acquisition debt to be allocated to Spain), provided that the portion of the debt pushed down to Spain is reasonable. In any event, it is generally advisable that a taxpayer seeks a binding tax ruling from the Spanish tax authorities to implement such a restructuring plan.

11 The Spanish CIT Act provides for an anti-hybrid rule transposing the contents of the ATAD 2 Directive (Directive 2017/952/EU, dated 29 May 2017 amending Directive 2016/1164/EU as regards hybrid mismatches with third countries). In a nutshell, the ATAD 2 regime aims at, among others, avoiding situations where deductions may be claimed by a Spanish CIT taxpayer and by another person in a different jurisdiction (a double deduction outcome) or where such deduction does not lead to the inclusion of matching income in another jurisdiction, as a consequence of a conflict in the characterisation of financial instruments, payments or entities. The scope of ATAD 2 is generally limited to related-party transactions, although such measures may apply in respect of third-party arrangements that are deemed to be 'structured arrangements' (i.e., an arrangement where the tax mismatch is priced into its terms, or which was designed to produce such an outcome). These rules apply in respect of all tax years ending after 11 March 2021.

reclassify debt instruments into equity instruments. The deductibility of interest incurred in connection with debt financing an equity distribution to the shareholders of the borrower entity (e.g., a dividend recap) should be reviewed on a case-by-case basis.¹²

Withholding tax

General rules

From a practical perspective, it is standard for foreign lenders to use EU-based vehicles to make loans to Spanish borrowers, as it is not market practice for borrowers to gross-up interest withholding tax (WHT) levied on payments made to lenders who are not ‘qualifying lenders’ (i.e., lenders entitled to an interest withholding exemption). As a general rule, payments of Spanish-sourced interest are currently subject to WHT at a 19 per cent rate. Tax haven-based lenders will be subject to this standard WHT rate. EU/EEA-based lenders (or EU/EEA permanent establishments of EU/EEA-based lenders)¹³ may receive interest free from Spanish WHT, subject to the fulfilment of compliance requirements (e.g., holding a valid government-issued tax residence certificate, or certain alternative certification requirements applicable to pension funds, CIVs and AIFs). Spanish-resident registered banks, registered Spanish permanent establishments of foreign banks and Spanish securitisation funds also benefit from the WHT interest exemption. Finally, certain tax treaties entered into by Spain may also provide for a WHT exemption on interest (e.g., the tax treaties entered into with Switzerland, the United States and the UK (which should place the UK lenders in a similar position to EU lenders upon Brexit)), also subject to the fulfilment of compliance and specific eligibility requirements.

Anti-abuse

Spanish tax law does not provide for a definition of ‘beneficial owner’ in respect of interest. In fact, the above-mentioned rule exempting interest payments made to EU lenders from WHT does not provide for a ‘beneficial ownership’ provision. Notwithstanding this, the Spanish domestic rule derives from the transposition of Directive 2003/49/EC (the Interest Directive) and the Court of Justice of the European Union (CJEU). The CJEU has analysed in the ‘Danish cases’ (C-115/16, C-118/16, C-119/16 and C-299/16) the concept of ‘beneficial owner’ under the Interest Directive, and concluded that the notion of beneficial owner (to be interpreted in a way consistent with the OECD standards) may be applicable by member states regardless of the inclusion of a beneficial ownership requirement in the domestic laws. Recently, the Spanish

12 Several Supreme Court decisions (following the decision dated 20 March 2021) ruled in favour of taxpayers in cases where the tax audit challenged the deductibility of interest accruing in connection with loans taken to finance distributions to shareholders, on the grounds that such interest was incurred for the benefit of the recipient shareholder and was unrelated to the business activity of the borrower. The courts rejected such view. Nonetheless, there is a recent anti-abuse report issued by the Spanish tax authorities addressing a structure where loan financing funded a share premium repayment following an intragroup reorganisation, which may suggest that the tax authorities may scrutinise certain leveraged distributions on anti-abuse grounds.

13 Except for EU/EEA-based lenders resident in or obtaining interest through a permanent establishment located in Spain or in a non-cooperative (i.e. tax-haven) jurisdiction. Currently, no EU or EEA member states are blacklisted from a Spanish tax perspective, but the Spanish tax authorities may revisit such blacklist depending on certain factors (e.g., where there is no effective exchange of tax information, or where the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes Identifies a jurisdiction as a tax haven).

Economic-administrative Court (Tribunal Económico Administrativo Central, TEAC), in a resolution dated 8 October 2019, echoed the Danish cases and concluded that the Spanish interest WHT exemption can only be claimed by the beneficial owner of the interest. There is still uncertainty as regards to how the administrative interpretation of this doctrine will evolve, but given the scope of the Danish cases (which addressed related-party lending structures and no third-party financing structures) and the background of the Spanish exemption rule, which apply regardless of the existence of borrowing between associated entities (and therefore it goes beyond the scope of the Interest Directive), there are grounds for supposing that the impact of this doctrine might be limited. In any event, back-to-back lending structures, shareholder loan financings, and sub-participation arrangements should be carefully reviewed in light of such precedents and of anti-abuse principles generally. An assessment of the robustness of a lending structure against such potential challenges must be carried out on a case-by-case basis.

Special regime for notes offerings

Spanish tax law provides for a special tax regime¹⁴ applicable to, inter alia, qualifying notes offerings made by Spanish resident companies and by wholly owned subsidiaries of Spanish companies resident within the EU,¹⁵ provided that certain additional requirements relating to the offering (e.g., the listing of the notes on a suitable exchange) are met, and certain compliance information is timely supplied by the paying agent involved. This regime provides for a WHT interest exemption on payments made to all foreign noteholders, regardless of their jurisdiction of residence (i.e., tax-haven investors are not penalised) and without requiring individualised tax documentation (such as government-issued tax-residence certificates) to be supplied.

Horizontal tax groups

As from fiscal years starting from 1 January 2015, the Spanish Corporate Income Tax Act (the CIT Act) has enlarged the scope of the tax consolidation regime, and allowed that Spanish subsidiaries of a common non-Spanish resident parent company¹⁶ form a horizontal tax group that would include all Spanish-resident direct or indirect subsidiaries in respect of which such ultimate non-Spanish parent company had a shareholding meeting the requirements described above (i.e., generally, 75 per cent of share capital, and majority of the subsidiary's voting rights). The wording of the law (and in particular, the rules governing the formation

14 Act 10/2014, dated 26 June, on the organisation, supervision and solvency of credit entities.

15 Notes offerings carried out by non-Spanish issuer vehicles, where the offering proceeds are ultimately used in Spain, should be carefully reviewed, in light of the criterion set forth in binding tax ruling V4139-15, dated 28 December 2015, where the Spanish tax authorities took the view that interest accrued under such notes could be deemed to be from Spanish sources for Spanish WHT purposes. In such cases, it would be crucial to ensure that the offering meets the criteria to be a qualifying note offering from a Spanish tax perspective, and that the applicable compliance obligations are duly met by the paying agent involved.

16 According to the CIT Act, a Spanish parent company (or permanent establishment) holding a direct or indirect participation in a Spanish subsidiary through intermediate holding companies resident in any country other than Spain could form a tax group including such indirect Spanish subsidiaries, provided that the indirect shareholding of such Spanish parent company represents (1) at least 75 per cent of the share capital of the Spanish subsidiary (70 per cent if the subsidiary has its stock listed in a regulated stock exchange); and (2) the majority of the subsidiary's voting rights. Parent companies resident in a tax-haven jurisdiction or not subject to a corporate-level tax are not eligible to be an ultimate parent company for purposes of the tax group regime.

of horizontal tax groups) creates several pitfalls that may affect a wide array of industries (e.g., multinational groups with Spanish investments, private equity sponsors, and financial institutions financing Spanish acquisitions).

For instance, under the horizontal group rules, a multinational group's parent company holding indirect investments in different businesses without any relationship whatsoever among them from an organisation standpoint (which is a fairly common situation in multinational conglomerates) could be deemed to be the parent company of a sole fiscal unity that should be automatically formed by all the Spanish entities it owns. Under the Spanish CIT Act provisions (which have already been interpreted by the Spanish tax authorities),¹⁷ if these indirect Spanish subsidiaries already formed their own tax groups in Spain, one of the pre-existing tax groups should cease to exist, with the degrouping charges that could derive from such a termination (i.e., recapture of certain intragroup gains that were eliminated in the past owing to the applicability of the consolidated tax regime). Spanish law does, however, not determine which tax group should be terminated.¹⁸

Another example of unwarranted implications of the horizontal group rules may be followed in private equity structures. Generally, private equity sponsors have 'master' holding companies in an EU jurisdiction and make leveraged buyout acquisitions through Spanish bidco vehicles partly financed through loans granted by financial institutions. Once the Spanish bidco acquires the shares of the Spanish 'target' company, bidco and target generally form a tax consolidated group. In such structures, the second Spanish investment made indirectly from the same master holding company (with the same bidco–target structure) may turn out not to be eligible to form a standalone tax consolidated group. The fact that there is a common parent company for both the first bidco and the second bidco would mean that the entities related to the second acquisition (i.e., the second bidco and the second target group) should form a single horizontal tax group.

Such an unwarranted outcome may be a great inconvenience for the private equity sponsor (as the financial models prepared for the first acquisition – prepared taking into account the features of the first target and the first bidco's leverage level – may be significantly changed)¹⁹ and for the financial institutions (as the formation of a horizontal tax group may imply an additional exposure to tax risks associated with companies that did not fall under the perimeter of the acquisition that was financed).²⁰

17 Temporary provision 25, subsection 2. This provision has been interpreted by the Spanish tax authorities in binding tax ruling V2037-15 (dated 30 June 2015). The case described in the mentioned ruling was the case of two Spanish consolidated tax groups that had a common parent company resident in Luxembourg. As per the Spanish tax authorities, as from fiscal year 2015 both groups should be combined into a single tax group (as the qualifying parent company of both groups was the same Luxembourg entity).

18 See binding tax ruling V2037-15. This means the taxpayer may choose to terminate the pre-existing group that could trigger fewer degrouping costs.

19 Several Spanish CIT rules require the fulfilment of requirements at the tax group level (for instance, the rules limiting the deductibility of interest), and the enlargement of a tax group may lead to unexpected tax inefficiencies (and to a greater tax compliance burden).

20 Entities belonging to a tax group are jointly and severally liable for the CIT debts of the group. In addition, the inclusion of entities in a tax group means that such entities may have accounts payable and receivable as regards other group entities, depending on whether an entity benefits from tax credits or attributes of another entity of the tax group. This aspect may also be troublesome from the perspective of the financial institutions involved.

While there may be strategies to structure investments to avoid the adverse implications of such regime,²¹ their implementation requires individualised tax advice.

III SECURITY AND GUARANTEES

i Parallel debt

Parallel-debt structures governed by Spanish law are not used in the Spanish market, as there is a risk of their being declared null and void pursuant to the Civil Code owing to the absence of a legal consideration supporting the creation of such autonomous, independent and abstract debt. Besides, the legal concept of trust is not regulated under Spanish law. Therefore, it is not court-tested whether a security agent under a syndicated finance deal would be able to validly hold any debt or security interest on behalf of the lenders acting as trustee pursuant to a parallel-debt structure. Accordingly, the relevant security interest must be granted in favour of each and every secured party. That being said, parallel-debt structures have been recently recognised in other civil law jurisdictions (e.g., France); therefore the possibility of future changes in this respect in Spain cannot be disregarded.

ii Limits to guarantees and security interests of Spanish guarantors

Limitations on guarantees provided by Spanish guarantors incorporated as SLs

Guarantees provided by Spanish guarantors incorporated in the form of *sociedades de responsabilidad limitada* (SLs) can only issue notes up to an aggregate maximum amount of twice its own equity, unless the issue is secured by a mortgage, a pledge of securities, a public guarantee or a joint and several guarantee from a credit institution. It is not fully clear if this limitation on SLs applies as well to the granting of guarantees or security interests in favour of notes.

Financial assistance

When structuring acquisition finance deals or refinancing previous acquisition finance deals, it is important to bear in mind that neither SLs nor *sociedades anónimas* (SAs, which are the most common form of big Spanish corporations) may secure or guarantee, or participate, help or render any sort of financial assistance for the acquisition of their own shares or quotas, or those of their parent companies. Further, SLs may not secure or guarantee, or participate, help or render any sort of financial assistance for the purchase of the shares or quotas of any company within their group. Any security interest or guarantee created that constitutes unlawful financial assistance in accordance with the foregoing rules is null and void. Additionally, financial assistance may raise civil liability issues for the directors and, potentially, may be criminal offences.

Unlike English law, Spanish law does not regulate a whitewash procedure and therefore, in the past, the traditional way to avoid financial assistance was the ‘forward merger’ between

21 For instance, the Spanish tax authorities have interpreted that certain investment structures with features designed to ensure that a ‘master’ holding company could not meet the requirements set out under the Spanish CIT Act to be regarded as a parent entity that could have the status of a head of a consolidated tax group (see, e.g., binding tax rulings V1813-16, dated 25 April 2016, and V1083-16, dated 17 March 2016). However, the use of such structures should be approached with caution, and on a case-by-case basis.

the bidco and the target, which should be backed by a valid economic reason in order for the merger to benefit from an advantageous tax regime. However, in 2009, the Structural Modifications Act²² introduced an exception to the general merger rules when the relevant merger implied financial assistance. By means of this law, in the case of a merger between two or more companies where any of them has incurred debt in the three years prior to the merger to acquire control of any of the other companies involved in the merger or to acquire assets of any of the other companies involved in the merger that are essential for normal operation or are significant for the equity value of said company, certain special rules apply, including that an independent expert appointed by the relevant mercantile registry must render an opinion on whether financial assistance exists. This generates uncertainty, and generally the forward merger leveraged buyout structure is no longer used, having been replaced with different debt pushdown mechanisms chosen on the basis of the accounting situation of either the target company or any of its material subsidiaries.²³ In this regard, in the framework of the legislation approved in Spain with the purpose of limiting the impact of the covid-19 crisis, it has been stated that, in general terms, companies taking advantage of the 'lay-off' proceeding (Record of Temporary Employment Regulation) shall not distribute dividends corresponding to the year in which such measures were in place impacting on the ability of the affected companies to push down debt.

By means of the above rules set forth in the Structural Modifications Act, the Spanish legislator (based on the former English whitewash procedure) has attempted to find a way for leveraged mergers not to result in financial assistance. Nevertheless, as previously stated, instead of clarifying doubts and filling gaps, this new piece of legislation has created even more doubts.

Nowadays, the usual approach is to assume that these restrictions also apply to a refinancing of debt incurred in connection with a previous acquisition.

While there are some practitioners that consider that the Spanish law financial assistance limitations applicable to Spanish companies shall be extended to its foreign subsidiaries, the extra territorial application of the Spanish financial assistance limitations is usually not the approach generally followed by the market.

iii Limitations on security and guarantee

The corporate benefit concept is not expressly recognised under the Spanish legal system. Nonetheless, several points should be borne in mind:

22 Act 3/2009 of 3 April on structural modifications of capital companies.

23 In addition, the performance of a post-LBO forward merger requires analysis from a Spanish tax perspective, as it is key that such merger can be performed in a tax-neutral fashion (which requires, inter alia, that the reorganisation is deemed to have been performed because of sound business reasons and not for tax-driven ones). Such mergers have been contested by the Spanish tax authorities in the past (especially in structures where the merger could give rise to certain tax advantages, such as the recording of amortisable goodwill), and it is market practice that such mergers are performed only to the extent a favourable advanced tax ruling is obtained from the Spanish tax authorities. On the other hand, the performance of a post-LBO reverse merger may pose fewer tax issues, and may entail certain advantages from a non-tax perspective, as such mergers may provide for a book-up of the balance of distributable reserves of the target company (from an accounting and corporate law perspective). Such additional reserves may provide for an additional buffer for distributions which – in case the acquisition debt is placed at the level of a holding company – may facilitate the servicing of acquisition debt.

- a* if a Spanish company grants security interests or guarantees where the transaction pursuant to which the security interest granted is not found to result in the ultimate corporate benefit of said company, the directors of that company could be in breach of their fiduciary duties; and
- b* to the extent that the power to grant security interest or a guarantee for the benefit of third parties is not included in the directors' powers, the directors may need to seek a special authorisation from the company's shareholders.

Under the Insolvency Act,²⁴ any agreement entered into by a Spanish company within the two-year period immediately preceding the petition of insolvency or the notice of the initiation of negotiations with the creditors or the intention to initiate them in order to reach a restructuring plan (as well as the agreements entered into between any of the aforementioned events and the declaration of insolvency by the relevant Commercial Court) may be rescinded by the relevant insolvency court, provided that the insolvency receiver deems that the terms of the agreement are detrimental to the insolvent estate, even if there was no fraudulent intention. Likewise, any agreements entered into by a Spanish company within the two-year period immediately preceding the date of the communication of existence of negotiations with its creditors, or the intention to commence such negotiations, to reach a restructuring plan pursuant to articles 585 et seq. of the Insolvency Act may be also rescinded (even if there was no fraudulent intention) unless:

- a* it is not approved a restructuring plan or being approved it is not homologated by the competent court; and
- b* the insolvency is declared within the year following the end of the effects of the aforementioned communication or of the extension that would have been granted.

In addition to the foregoing, the Insolvency Act contains a presumption by virtue of which it shall be deemed to be detrimental to the insolvency state, and therefore it shall be declared null and void, any *in rem* security granted, within the clawback period, as collateral for either an existing obligation or a new obligation in replacement of an existing one.

However, any security interest and guarantee granted within the context of an homologated restructuring plan will not be subject to the aforementioned presumption, to the extent that the relevant restructuring plan affects at least, 51 per cent of the total liabilities of the debtor, unless it is proven that the security interest was granted in fraud of creditors.

In view of the above, corporate upstream guarantees may be challenged to the extent that they do not result in a tangible and identifiable interest to the guarantor beyond the abstract group interest.

²⁴ Royal Legislative Decree 1/2020 of 5 May 2020, as amended by, among other, Law 26/2022 of 5 September (by means of which the Directive 2019/1023/EU of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt has been transposed into Spain. Law 26/2002, by virtue of which the restated Insolvency Act was approved to organise, harmonise and clarify the insolvency law, which had suffered numerous root-and-branch amendments. It does not include substantial amendments although, as mentioned above, the legislator has taken advantage of the recast to clarify certain provisions that could lead to false interpretations.

In a non-insolvency situation, the corporate benefit requirement still applies. However, it does not need to be quantified, and it will not prevent a guarantee from covering working capital facilities that are not linked to the acquisition of the company's or its holding company's shares or quotas.

SLs must obtain their shareholders' approval prior to issuing upstream guarantees.

Although there are some practitioners that understand that the shareholders' meeting shall approve the granting of security interest over assets that may be considered essential for the company, there is no market standard in this regard. However, this is typically seen as a CP in the framework of LBOs in Spain.

iv Security

The most typical securities in the Spanish market are real estate mortgages and pledges over shares or quotas,²⁵ bank accounts and credit rights. Promissory mortgages are also not unheard of in the Spanish market, although they may not be considered security interest but just an undertaking to create security interest.

A universal floating catch-all security interest, similar to an English law debenture or US Uniform Commercial Code security interest, is not recognised under Spanish law. In contrast, each security interest over each asset class is documented in a separate deed and signed before a notary public. In this sense, Spanish law security documents must accurately describe the assets that are subject to a particular charge.

The possibility of creating a single global pledge to secure multiple liabilities is not expressly regulated by the Spanish Civil Code; however, there are grounds to sustain the validity of security interests and guarantees being granted in respect of multiple liabilities. Royal Decree 5/2005, for example, allows for the creation of a single financial security interest to secure several obligations. The use of global real estate mortgages to secure multiple liabilities is also recognised and regulated by Article 153-bis of the Spanish Mortgage Law dated 8 February 1946. Lastly, the use of personal guarantees to secure multiple liabilities was expressly recognised by Article 98 of Spanish Royal Decree Law 3/2011 of 14 November, which approved the Consolidated Text of the Public Sector Contracts Act. However, Article 98 of the former Public Sector Contracts Act was repealed by Act 9/2017, of 8 November, which approved the new Public Sector Contracts Act, which entered into force on 9 March 2018. As a consequence of the above, there are also grounds to sustain the validity of global pledges, even though a different view from the competent courts cannot be disregarded.

Mortgages

As a general rule, pursuant to the principle of speciality, each mortgaged asset may secure the obligations arising from one debt instrument only. However, when all lenders are financial entities (as defined in Article 2 of the Spanish Mortgage Market Act)²⁶ and certain formal requirements are also met, the relevant mortgage may be created in the form of a maximum liability mortgage, which may secure several present or future obligations arising from several debt instruments up to the said maximum liability.²⁷

25 The share capital of an SL is represented by 'quotas', whereas the share capital of SAs is represented by 'shares'. This distinction is especially important with regard to the application of RDL 5/2005 (see below).

26 Act 2/1981 of 25 March, on the regulation of the mortgage market.

27 Article 153-bis of Spanish Mortgage Law dated 8 February 1946.

Spanish law mortgages can be created over real estate assets and over movable assets such as intellectual property rights, industrial machinery, aircraft, vehicles and business premises; as a perfection requirement, they must all be registered with the relevant public registry.

The mortgage deed must expressly mention, among others, the maximum amount of the underlying obligations that is secured by the mortgage. In this sense, it is important to carry out a cost-benefit analysis, given that stamp duty must be paid on the basis of the maximum secured amount. Currently, the stamp duty applicable to public deeds of mortgage may generally range between 0.5 and 2 per cent of the secured amount (depending on the region where the asset is located).

Since November 2018, following a long court controversy regarding the party who should be liable for stamp duty upon the grant of a mortgage loan, the Spanish government enacted legislation shifting taxpayer status to the lenders, regardless of the type of loan, the status of the lender (bank or otherwise) or the status of the borrower (e.g., consumer, individual or corporation). From a practical standpoint, however, lenders often demand that borrowers contractually bear the cost of stamp duties, although lenders will continue being liable for such payment before the Spanish tax authorities.

Assignments of commitments under the relevant facility agreement between lenders do not automatically result in the assignment of the assigning lender's participation in the mortgage. The assignment of the mortgage must be expressly documented and registered with the relevant public registry in order for the acquiring lender to become a mortgagee of record. Further, stamp duty is levied on the basis of the commitment being transferred.

The mortgage deed must include the Spanish tax identification numbers of all of the parties to enable the Spanish authorities to identify each party thereto.

Pledges

As stated above, Spanish law does not expressly regulate the possibility of creating a single global pledge to secure several obligations. However, Royal Decree 5/2005 allows the creation of single financial security interest to secure several obligations and global real estate mortgages are expressly regulated by Article 153-bis of the Spanish Mortgage Law dated 8 February 1946. In this sense, based on the acceptance of the application by analogy of the mentioned regulations, it is a widespread market practice to grant a single global pledge to secure several obligations, which is generally considered acceptable in Spanish academic literature.

There are two main types of pledges under Spanish law: pledges with transfer of possession and pledges without transfer of possession.

Pledges with transfer of possession

Pledges with transfer of possession require the possession of the pledged asset to be transferred to the creditor or to a third party for the purposes of perfecting the pledge. For assets that are not physically transferable, there are presumptions that certain actions (e.g., granting the pledge as a Spanish deed, delivering notices) are equivalent to transferring possession of the relevant asset.

Under certain circumstances, pledges with transfer of possession may be subject to RDL 5/2005,²⁸ which incorporated the European Financial Collateral Directive²⁹ into Spanish law and aims to facilitate enforcement of financial collateral arrangements.

To benefit from this regime, the following requirements, inter alia, must be met:

- a at least one of the parties 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;
- b the pledged asset must be cash (i.e., the money credited to an account in any currency); marketable securities³⁰ and other financial instruments; or specific receivables (i.e., those money claims arising out of an agreement whereby a credit institution grants credit in the form of a loan agreement or a credit line); and
- c the financial collateral arrangement must have been formalised in writing.

The main advantages of RDL 5/2005 for lenders are as follows:

- a no formalities (e.g., registration, notices) are required other than documenting the arrangement in writing, the provision of the collateral, to either the beneficiary or any person acting on its behalf, and constancy of such provision in writing or in a legal equivalent manner;
- b it allows for the direct sale or appropriation of the pledged asset;
- c it provides certain protections against insolvency, given that the initiation of insolvency proceedings is not considered sufficient grounds to declare null or to rescind or to suspend the enforcement of a financial collateral arrangement; and
- d compensation agreements subject to RDL 5/2005 shall not be affected by a declaration of insolvency.

In light of a judgment issued by the CJEU on November 2016,³¹ there is a risk that a pledge over bank accounts may not qualify as a financial collateral arrangement if the account holder may freely dispose of the monies deposited in the account. This does not mean that pledge would become null or unenforceable but that the relevant beneficiary would not benefit from the advantages provided by the RDL 5/2005 for the financial collateral arrangements.

Finally, certain Spanish regional rules may apply depending on where the pledged assets are located.

28 Royal Decree Law 5/2005 of 11 March on urgent reforms for boosting productivity and to improve public procurement.

29 Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

30 Quotas in an SL do not qualify for these purposes.

31 Judgment dated 10 November 2016 in the Matter No C-156/15 (*Private Equity Insurance Group (SIA) v. Swedbank AS*) in response to a request for a preliminary ruling from the Supreme Court of Latvia.

Pledges without transfer of possession

Pledges without transfer of possession do not require the possession of the pledged asset to be delivered. However, they must be registered in the relevant movable assets registry as a perfection requirement.

Unlike mortgages, provided the pledge is granted as a Spanish commercial deed and not as a notarial deed, no stamp duty will be levied, but it attracts certain other costs, such as notarial and registration fees. However, the deed of pledge must still include a reference to the maximum amount of secured obligations that is secured by the pledge without transfer of possession. Spanish tax identification numbers are required to have the pledge registered.

As regards assignments between lenders, similarly to mortgages, the assignment of a lender's position under a pledge without transfer of possession must be expressly documented and registered with the relevant public registry.³²

Similarly to pledges with transfer of possession, Spanish regional rules may apply depending on where the pledged assets are located.

Market participants are structuring pledges over credit rights as pledges with transfer of possession to avoid registration requirements.

Promissory mortgage

Promissory mortgages are not unusual in Spanish finance deals. A promissory mortgage does not create an *in rem* right of mortgage, but rather creates an obligation for the grantor in relation to the relevant lenders party thereto to create an *in rem* right of mortgage upon the occurrence of the agreed trigger event.

Promissory mortgages are typically used when the amount of stamp duty that would be levied on the relevant mortgage deed is too large compared with the risk of default or, generally, with the benefit of creating a mortgage upon closing a deal.

In any case, lenders should bear in mind that the conversion of the promissory mortgage into a legal mortgage requires the payment of the stamp duty that was initially avoided, and that it entails significant insolvency limitations and a rescission risk.

Irrevocable powers of attorney

It is usual in the Spanish market to have the mortgagor or pledgor grant a special power of attorney in favour of the security agent (or even the secured parties) to carry out certain actions on its behalf. Pursuant to such irrevocable power of attorney, the security agent is typically authorised to carry out perfection, further assurance and enforcement actions on behalf of the relevant mortgagor or pledgor with respect to the relevant security documents. To ensure that the mortgagor or pledgor may not unilaterally revoke the power of attorney, the security agent is usually party to the deed of power of attorney, and certain specific language is included.

It is worth mentioning that the scope of the powers granted in favour of the security agent or secured parties should be carefully defined to avoid their potential classification as shadow directors in an insolvency proceeding of the grantor.

32 See Section III.ii.

Finally, under Spanish common law, powers of attorney, appointments or authorisations granted, whether or not stated to be irrevocable, are generally revocable by the grantor, provided that the revocation is in good faith. Moreover, irrevocable powers of attorney shall become unenforceable in case of insolvency.

IV PRIORITY OF CLAIMS

i Types of claims

Once insolvency has been declared, the court receiver draws up a list of acknowledged claims and classifies them according to the following categories.

Claims against the insolvency estate

These claims are payable when due according to their own terms (and, therefore, are paid before all other claims under insolvency proceedings; see below). Claims against the insolvency estate include the following:

- a a certain amount of the employee payroll;
- b the costs and expenses of the insolvency proceedings;
- c certain amounts arising from services provided by the insolvent debtor under reciprocal contracts and outstanding obligations that remain in force after insolvency proceedings are declared, and certain amounts deriving from obligations to return and indemnify in cases of voluntary termination or breach by the insolvent debtor;
- d amounts deriving from the exercise of a clawback action during the insolvency proceedings regarding certain acts performed by the insolvent debtor and corresponding to a refund of consideration received by it (except in cases of bad faith);
- e certain amounts arising from obligations created by virtue of law or from tort after the declaration of insolvency and until its conclusion;
- f 50 per cent³³ of the funds lent under a refinancing arrangement entered into in compliance with the requirements set forth in Article 614 et seq. (restructuring plans) of the Spanish Insolvency Act; and
- g certain debts incurred by the debtor following the declaration of insolvency.

Insolvency claims

Insolvency claims are subject to the insolvency proceedings and, unlike the claims against the insolvency estate, are paid in accordance with the waterfall set forth in the Spanish Insolvency Act. In principle the insolvency waterfall applies mandatorily; that said, such waterfall may be altered among the creditors that are party to a contractual subordination agreement to the extent the debtor is party to such agreement and it is not caused any prejudice to any third parties.

33 From 2 October 2016, 50 per cent of the new funds under a formal refinancing are regarded as a claim against the insolvency estate and the remaining 50 per cent as a generally privileged claim.

Insolvency claims, in turn, are classified as follows:

- a special privilege claims, which basically refers to claims which benefit from certain security interest on certain assets (essentially *in rem* security, to the extent secured by *in rem* security);³⁴
- b general privilege claims, which refers to, among others, certain labour debts and certain debts with public administrations corresponding to tax debts and social security obligations (which are recognised as generally privileged for half of their amount), and debts held by the creditor applying for the corresponding insolvency proceedings (to the extent such application has been approved) up to 50 per cent of the amount of such debt. Up to 50 per cent of the amount of either any interim financing (*financiación interina*)³⁵ or new financing (*nueva financiación*)³⁶ provided within the framework of an homologated restructuring plan shall also benefit from general privileges, to the extent that the claims affected by the relevant plan represent at least 51 per cent of the total liabilities of the insolvent debtor. In the same line, in case the interim financing or the new financing is provided by parties who are specially related to the debtor, 50 per cent of the amount of such financings shall also benefit from general privileges to the extent that the claims affected by the relevant restructuring plan represent at least 60 per cent of the total liabilities of the insolvent debtor (deducting the claims held by any specially related person to the insolvent debtor to calculate the aforementioned majority);
- c ordinary claims (unsubordinated and non-privileged claims); and
- d subordinated claims. Debts subordinated by virtue of law include, inter alia, claims that have been notified late by the creditors (other than claims of mandatory recognition), fines, profit participation loans, claims related to accrued and unpaid interest unless and to the extent they are secured by an *in rem* right, as well as, in particular, credit rights held by parties that are specially related to the debtor (discussed further in Section IV.ii).

Subordination

Credit rights may be subordinated by virtue of law, by contractual agreement or as a result of the structure of the debt. Contractual subordination must be accepted by all of the creditors whose claims are affected by the relevant subordination.

Contractual subordination agreements are now recognised within insolvency proceedings provided that (1) the insolvent debtor is party to such agreements and (2) those agreements do not cause prejudice to any third parties. Contractual subordination agreements are binding to the insolvency administrators, who shall make the payments in accordance

34 For the purposes of a composition or a restructuring plan, the special privilege shall be limited only to the reasonable or fair value of the charged asset. The amount in excess of such reasonable or fair value will not be considered as a special privilege claim. This limitation does not apply to the right of the secured creditor to recover the amount secured or guaranteed by the relevant security interest or guarantee, as applicable.

35 Interim financing (*financiación interina*) is referred to in the Spanish Insolvency Act as any financing provided to the debtor while the debtor is negotiating a restructuring plan with its creditors, to the extent, such financing is reasonably needed to: (1) ensure the continuity of the debtor's business or professional activity during such negotiations; or (2) preserve or improve the value which the business, as a whole, or of one or several productive units (*unidades productivas*), had at the time of the commencement of such negotiations.

36 New financing (*nueva financiación*) is referred to in the Spanish Insolvency Act as financing that is foreseen in the restructuring plan and is necessary for the fulfilment of such plan.

with the relevant rules or waterfalls set out in such agreements. Contrary to what happens in an insolvency scenario, contractual subordination agreements have not been expressly recognised for the purposes of class formation to vote the approval of a restructuring plan.

Pursuant to the Insolvency Act, credit rights held by parties that are specially related to the debtor are subordinated. In the case of individuals, this includes their relatives. In the case of legal entities, this includes:

- a* shareholders, group companies and their common shareholders, provided that:
 - they are personally liable for the debtor's debts;
 - they owned directly or indirectly over 5 per cent (for companies that have issued securities listed on an official secondary market) of the entity's share capital when the relevant debt was incurred; or
 - they owned directly or indirectly over 10 per cent (for companies that have not issued securities listed on an official secondary market) of the entity's share capital when the relevant debt was incurred; and
- b* directors and de facto (shadow) directors, liquidators and attorneys holding general powers of attorney, as well as those who held such positions within the two years immediately preceding the initiation of insolvency proceedings.

In addition to the above, there is a presumption that any persons who have acquired credit rights from the specially related persons described above within the two years immediately preceding the initiation of insolvency proceedings are also specially related to the debtor. Therefore, such claims will become subordinated.

Notwithstanding the above, it is noteworthy that creditors who have capitalised all or part of their claims pursuant to an homologated restructuring plan in accordance with Articles 635 et seq. of the Insolvency Act are not deemed specially related persons as a result of said restructuring; and any creditors who are party to an homologated restructuring plan are deemed not to be de facto directors because of the obligations assumed by the debtor pursuant to said restructuring plan (although evidence to the contrary may be admitted).

V JURISDICTION

Choosing the laws of any jurisdiction other than Spain will generally be given effect by the Spanish courts subject to, inter alia, the terms of the Rome I Regulation³⁷ and in accordance with the exceptions and provisions of the laws of Spain, provided that the relevant applicable law is evidenced to the Spanish courts pursuant to Article 281 of the Spanish Civil Procedure Act,³⁸ and pursuant to Article 33 of the Act on International Legal Cooperation in Civil Matters.³⁹

Further, a final judgment obtained against any debtor or guarantor in a country other than Spain that: (1) is not bound by the provisions of EU Regulation No. 1215/2012;⁴⁰ and is not party to an international treaty providing for the recognition and enforcement of

37 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).

38 Act 1/2000 of 7 January on Civil Procedure.

39 Act 29/2015 of 30 July on International Legal Cooperation in Civil Matters.

40 Regulation (EU) No. 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

judgments between Spain and the countries where the judgments were rendered, would be recognised and enforced by the courts of Spain in accordance with and subject to Article 523 of the Spanish Civil Procedure Act and subject to the Act on International Legal Cooperation in Civil Matters.⁴¹

The party seeking enforcement should initiate the recognition proceedings in Spain before the relevant Court of First Instance or Commercial Court, as the case may be. According to Article 46 of the Act on International Legal Cooperation in Civil Matters:

a final foreign judgment would not be recognised:

(a) if the judgment contravenes Spanish public policy rules (orden público);

(b) if the judgment was rendered infringing the rights of defence of either party. If the judgment was rendered by default, it would be understood that the rights of defence have been clearly infringed provided that the defendant was not served with the document that instituted the proceedings in a timely manner that allowed for adequate defence;

(c) if the judgment addresses a matter over which Spanish courts have exclusive jurisdiction or, in relation to other matters, if the jurisdiction from the court of origin over the matter is not clearly connected to said country of origin in which the judgment was rendered;

(d) if the judgment is irreconcilable with a judgment rendered in Spain;

(e) if the judgment is irreconcilable with an earlier judgment rendered in any other State provided that such judgment complies with the applicable conditions to be recognised in Spain;

(f) if there is judicial proceeding outstanding in Spain between the same parties and in relation to the same issues in Spain, instituted before the foreign proceeding.

The Act on International Legal Cooperation in Civil Matters expressly prohibits that a foreign judgment is reviewed as to its substance by the Spanish competent court.

Finally, any judgment obtained against any debtor or guarantor in any country bound by the provisions of EU Regulation No. 1215/2012 would be recognised and enforced in Spain in accordance with the terms set forth therein.

VI ACQUISITIONS OF PUBLIC COMPANIES

Loans financing tender offers are not that different from non-public acquisition finance deals, although lenders need to focus on the bank guarantees that the Spanish Securities Market National Commission (CNMV) requires as evidence that the relevant acquirer will be able to comply with its obligations under the public offer to purchase, to make sure that these are adequately integrated in the financial documents and to consider the unconditional nature of these guarantees at the time issued. That said, there are a series of specific provisions that are normally included in this kind of financing, such as, undertakings related to the offer which could prevent the bidder from amending certain terms or conditions to which voluntary offers may be subject to, a mechanism regulating the replacement of the aforementioned guarantees in case additional lenders join the original guarantee providers once the aforementioned guarantees have been deposited with the CNMV, a ‘deemed-utilisation’ mechanism by means

⁴¹ The Act on International Legal Cooperation in Civil Matters repealed Articles 951–958 of the former Spanish law civil procedural of 1881.

of which the enforcement of the guarantees by the CNMV would constitute an automatic drawdown under the financing for the relevant claim amount, the obligation of the bidder to pledge the target shares in favour of the lenders once the offer is settled.

Offer prospectus must give details about how the tender offer is going to be financed, and therefore certain details of the relevant debt instruments will need to be made public.

Spanish stock corporations are governed by the Spanish Securities Market Act,⁴² as further developed by Royal Decree 1066/2007, of 27 July, on the rules applicable to takeover bids for securities and amended by Act 4/2015. The Spanish authority responsible for approving any takeover bid launched is the Spanish Securities Market National Commission.

When someone directly or indirectly acquires control over (i.e., has at least 30 per cent of the voting rights) a publicly listed company, a tender offer for all outstanding shares in that company is mandatory. The mandatory takeover bid will also be triggered when someone does not hold more than 30 per cent of the voting rights but has appointed, within 24 months following the acquisition, a number of directors that, together with those already appointed by the bidder, if any, represents more than one-half of the members of the board of directors.

The aforementioned threshold can be obtained:

- a* by means of an acquisition of shares or other securities that confer, directly or indirectly, voting rights in such company;
- b* through shareholders' agreements; or
- c* as a result of indirect or unexpected takeovers.

Without prejudice to the above, the Spanish Securities Market Act provides for certain exceptions for the launching of a mandatory offer upon gaining control of a listed company; for instance, creditors acquiring the control of a listed company as a result of the capitalisation of their debt within the context of an homologated restructuring plan which is favourably informed by an independent expert will not be obliged to launch a mandatory tender offer without necessity of getting an exemption from the Spanish Stock Exchange Commission.

Mandatory takeover bids must be made at an 'equitable price', that is to say, an equal price to the highest price that the party required to launch a takeover bid (or those persons acting in concert with it) has paid for the same securities during the 12 months prior to the announcement of the bid. Contrary to this, in a voluntary takeover bid, the bidder is free to offer whatever price it wishes.

VII THE YEAR IN REVIEW

This year has been outstanding for investment activity, with a huge recovery since the slowdown caused by the covid-19 crisis. Private capital has been very successful and this fact, together with low interest rates, has helped fundraising to end 2021 at near record figures.

Increasing regulation and global protectionism, trends globally consolidated in the past few years, are here to stay and the progressive end of the covid-19 pandemic did not bring a relaxation of those restrictions, which seem to be here to stay.

42 Ley 24/1988, de 28 de julio, del Mercado de Valores, as restated by Legislative Royal-Decree 4/2015, of 23 October.

VIII OUTLOOK

The worldwide macro environment will suffer from high uncertainty. The low interest rate environment seems to be over, at least for a while, until central banks are able to reduce the high inflation rates that will cause material damage to individuals and companies.

Direct lending is expected to step in and fill the supply gap left by the less risk-tolerant and heavily regulated banking sector. All practitioners expect that direct lenders will win traditional lenders' market share year after year.

In this framework the new Insolvency Act, in particular the heavily updated pre-insolvency institutions, are expected to play a major role in order to help debtors and creditors to restructure debt following much more flexible rules. It is still unknown if the archaic Spanish mercantile courts will be able to accommodate this new weapon and to become allies of the market players in order to achieve this goal.

We also anticipate a strong growth in ESG and sustainability-related loans and bonds. Several KPIs will be applicable to the different economic sectors, and the particularities of those products will go beyond their pricing. We anticipate more ESG regulations on top of the EU's taxonomy for sustainable activities, both at a national and European level.

We would also expect the top-tier Spanish acquisition finance market to continue its process of incorporating the latest front-running US and London leveraged finance structures and trends.

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