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Client Alert

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Spanish Insolvency Act Changes — Paving the Way for Restructurings

Executive Summary

- The Spanish Government has amended the Spanish Insolvency Act in order to provide more certainty on its application and to encourage the refinancing of viable companies;
- Although the market is still waiting for a more substantial revamp of the Spanish Insolvency Act, some of the measures are a good incentive for restructuring strategies;
- It is time now for the courts and restructuring professionals to apply these new provisions in light of the policy goal of refinancing viable companies.

"This reform is aimed to make Spain a more creditor-friendly jurisdiction."

Introduction

The Spanish Government introduced changes to the Spanish Insolvency Act of 2003 (the SIA) on 27 March 2009 as part of a legislative package intended to stimulate the economy.

Some of the changes are clearly intended to clear the way for refinancings and restructurings. The Spanish authorities increasingly have become aware of the potential that restructuring strategies such as debt-for-equity swaps or consensual out of court schemes may have as tools to rescue distressed companies. In this respect, they are conscious of the need for urgent reform to address current issues which the Spanish insolvency courts face in dealing with the SIA and acknowledge a more substantial and structural overhaul of the SIA may also be required.

Specifically, the changes address the following matters: (i) restrictions on the claw back of refinancing agreements; (ii) the position of specially related persons for equitable subordination purposes; (iii) encouraging fast-track composition agreements; (iv) improving the insolvency procedure (the Concurso) and reduction of associated costs; (v) improving the liquidation procedure for non-viable companies and (vi) reinforcing the position of certain claimants, in particular the employees of an insolvent entity.

This *Client Alert* will exclusively focus on the implication of the changes from a refinancing and restructuring standpoint for banks, financial institutions, funds and intermediaries operating in the Spanish restructuring market.

Refinancings of Viable Companies and Restrictions on the Claw Back of Refinancing Agreements[1]

The reform of the SIA clarifies the concept of refinancing for the purposes of the claw back regime.

Before the changes to the SIA, any agreements prejudicial to a debtor company's estate entered into in the two years prior to the declaration of

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insolvency (Concurso) were subject to claw back, even if there was no fraudulent intention. Under some circumstances there was a presumption that the creation of any *in rem* security in connection with pre-existing obligations or with new obligations in substitution of prior ones was an agreement prejudicial to a debtor company's estate. Claw back has been a constant issue for Spanish refinancings prior to insolvency (Concurso) as the grant of new security has been a common feature of refinancings. As a result, there has been much uncertainty in the Spanish restructuring community on refinancings, the creation of security and claw backs.

To address this, the Spanish Government has introduced an exception to the claw back presumption in connection with certain refinancings. This is designed to provide more certainty to facilitate out of court restructurings involving refinancings and the creation of security.

Pursuant to the changes, if a Concurso is declared, refinancings and any transactions, acts, payments and security entered into in connection with it will not be subject to claw back provided that the refinancing agreement:

(i) is executed by creditors whose claims represent at least 60 percent of the debtor company's debt at the date of the refinancing agreement;

(ii) the refinancing agreement is assessed by an independent expert appointed by the Commercial Registry corresponding to the place of the debtor's registered office. The independent expert's report shall include a technical opinion on (a) the adequacy of the information provided by the debtor company; (b) the reasonability and viability of the refinancing, and (c) the reasonableness of the security being taken in view of the market conditions at the date of the refinancing agreement; and

(iii) is formalized by means of a public instrument.

For the purpose of the changes, refinancings comprise agreements executed by a debtor company as part of its plan in the short to medium term pursuant to which borrowings are significantly increased or obligations are amended either by a maturity extension or the creation of new obligations in substitution of existing ones.

Importantly, refinancings can now only be challenged by receivers (and not by creditors if receivers did not do so).

There are certain transitional provisions which apply to refinancings and transactions, acts, payments and security entered into before 1 April 2009 provided that the debtor company has not filed for insolvency on or prior to that date.

Specially Related Persons for the Purposes of Equitable Subordination

Under the SIA, specially related persons of a debtor company include creditors who hold at least 5 percent of the share capital if a debtor company is listed or 10 percent of the share capital if it is not listed. The debt held by specially related persons can be subordinated to the debt of all other creditors.

The changes to the SIA make it clear that a shareholder becomes a specially related person for the purposes of equitable subordination on the date when the loan is granted.

This now means that any creditor of a debtor company that carries out a debt-for-equity swap and acquires shares in excess of the 5 percent or 10 percent threshold will not risk having its debts equitably subordinated provided that it did not hold shares in excess of those thresholds at the time the loan was granted or is not appointed a director of the debtor company in the two years prior to the date of the Concurso.

Encouragement of Fast-Track Composition Agreements

The changes to the SIA encourage the filing of fast-track composition agreements including the following:

- the obligation of a debtor company to file for insolvency within two months of becoming aware of the insolvency situation is now suspended for

another three months if the company, being already insolvent, starts negotiations with creditors to secure a fast-track composition agreement and that circumstance is duly notified to the court within the initial two month period. After the three month period has elapsed, the company must file for insolvency within the following month. In our view, this will assist out of court restructurings at the same time that it protects a debtor company against creditor filings for insolvency; however, in connection with the analysis of this new regulation, recent case law at lower courts is setting out very strict evidence requirements of the situation of insolvency, a trend that may hinder this alternative for many debtors;

- a fast-track composition agreement can now be filed at the time a debtor company files for insolvency: 10 percent creditors' support is required instead of the 20 percent required if the proposal is filed at a later stage. In our view this will also assist out of court proposals;
- a lower quorum (now a simple majority) is required to approve fast-track composition agreements provided that any debt write off is less than 1/3 of the claims outstanding or the stays are shorter than three years; and
- subordinated creditors can now count towards the simple majority quorum which should make it easier to file fast-track composition agreements.

Other Changes

Other changes include: (i) a new written procedure for composition agreements, instead of separate creditors meetings when the number of creditors exceeds 300; (ii) the compensation of the receivers (introducing a reduction on the fees that those are entitled to); (iii) the classification of certain claims (held by public authorities, by contracting parties and regarding third-party guarantors) and (iv) no prior report required by the public authorities for the courts to authorize a composition agreement for companies of "special relevance for the economy" where there is a debt write off greater than 50 percent of the total debt or a stay longer than five years and introduces the possibility of a fast track liquidation of the debtor.

Conclusion

This reform is aimed to make Spain a more creditor-friendly jurisdiction. It has been certainly driven by cases such as *Martinsa-Fadesa* and *Habitat* which have highlighted to the restructuring community the risks of employing restructuring strategies in Spain that are widely accepted in other jurisdictions such as the UK or Germany.

With the amendments to the SIA, some restrictions have been introduced to contain the risk of claw back actions against the refinancing agreements. In addition, the changes have opened the door for debt-for-equity swaps by introducing improvements such as (i) the suspension of the debtor's obligation to file for insolvency when the debtor has initiated negotiations with creditors in order to secure a fast-track composition agreement; (ii) the clarification of the concept of specially related persons for equitable subordination and (iii) the ease of the approval of a fast-track composition agreement.

This reform was broadly supported by the market and has been embraced by Spanish financial institutions. Now it is time for the courts to apply the changes in light of the policy aim: avoiding the high number of debtors that file for insolvency against a background where 90 percent of insolvency proceedings to date have led to liquidation of the debtor.

Endnotes

1 The intention is showing that the reform tries to incentivate the refinancings.

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