Refinancing agreements: is there a new paradigm in the Spanish insolvency system?

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In a decision dated 23 July 2015 the commercial court of Bilbao number 2 ruled on the challenge of an agreement to refinance a syndicated bank debt (originally in excess of € 1,7 billion) that had been reached in January 2015 by Eroski and the majority of its banks pursuant to additional section 4 (AS4) of the Spanish Insolvency Act (SIA).

The judgement dismissed the challenge and said that the reforms of the SIA passed over the last two years or so entail a "change of paradigm" in the Spanish insolvency system, whereby the avoidance of the declaration of insolvency is now its main aim, rather than maximizing creditors' recovery. The rationale of the new paradigm is, according to this judgement, to maximize the total economic welfare and the interests of the State and employees through the preservation of the economic activity of the debtor.

Although it is true to say that the last reforms of the SIA have placed a greater emphasis on the preservation of debtors' activity, it seems to us that, from a purely legal point of view, the claim that the insolvency paradigm has changed so dramatically is arguable. However, this idea has somehow percolated through the judiciary and is having a clear influence on "the bottom line" of a number of judicial decisions. A good example of this is probably the Eroski decision that we comment in this note.

The purpose of the January 2015 refinancing agreement discussed in this decision was to "restructure" a previous (and unsuccessful) agreement reached two years earlier to refinance a syndicated loan granted to Eroski in June 2007.

The dissenting banks challenged the January 2015 refinancing agreement on the grounds, *inter alia*, that it imposed upon them a disproportionate sacrifice when compared with the new conditions contemplated for the majority of the banks.

In broad terms, under the AS4, dissenting financial creditors can be dragged into a refinancing agreement provided certain majorities and other conditions are met. However, dissenting creditors can challenge the agreement when it imposes upon them a disproportionate sacrifice. The burden of proof lies with the dissenting creditors[1].

Although the SIA is silent on the matter, the Bilbao court held that in order to gauge whether or not a sacrifice is disproportionate different criteria can be used, comparing:

1. The situation of the dissenting creditor before and after the refinancing agreement;
2. The recovery the dissenting creditor could expect if the refinancing agreement were not approved, as opposed to the recovery it could obtain through the refinancing agreement;

[1] See our notes "*A new legal tool for debt restructuring in Spain*" of October 2013 and "*A new regime for the refinancing of distressed companies*" of March 2014.

3. The situation of the dissenting creditor resulting from the refinancing agreement vis-à-vis the situation of those creditors that voted for it. This is the criterion that the court considered more appropriate. In the court's view, it is fair that a refinancing agreement treats differently creditors that were in a different situation before the refinancing (for instance, secured or non-secured).

There are other criteria not mentioned in the Eroski judgement that have been invoked in other court decisions. This is the case, for instance, of the Barcelona commercial court number 3 leading decision of 29 July 2014 (Petromiralles). According to Petromiralles, a sacrifice can be disproportionate if and to the extent that:

1. It is not strictly necessary to make the company viable;
2. The whole refinancing agreement has been approved by a massive majority of creditors or, in other words, when dissenting creditors' stake is not really meaningful (for instance, 10 or 5 per cent).

Therefore, according to Petromiralles it would be consistent with the above criteria to approve a refinancing agreement that provided a more favorable regime (for instance, new security) to those creditors that have voted for the refinancing and committed to new or extended credit facilities. This way, financial creditors have an incentive to vote for the refinancing, instead of letting the company fall in insolvency.

A key assumption that the court made in Petromiralles was that the refinancing plan was viable and should allow creditors to recover their claims. It also assumed that even if the refinancing plan failed the assets of the debtor should suffice to pay off the bank debt in its entirety.

The Eroski court decision referred to the doctrine laid down in Petromiralles, and found that, in order to determine whether dissenting creditors were actually suffering a disproportionate sacrifice, the term of comparison should not be the situation in which they were as a result of the 2013 "restructuring" agreement, but that in which they were when the first syndicated financing was put in place in June 2007. In other words, it was not right to "reset the chronometer" in January 2013. The reason was, according to the court, that the 2013 restructuring was rather a sort of *extend and pretend* refinancing (that was not really viable).

The Eroski case raises other issues that in our opinion are far from clear. According to the AS4, refinancing agreements can only drag dissenting creditors in relation to certain stays and write-offs or the conversion of claims into participative loans (see, for instance, Petromiralles or the decision of the Pontevedra commercial court number 2 of 13 February 2015 in the San José refinancing). However, it is not obvious that the Eroski court decision did not go beyond those limits imposing upon dissenting creditors other types of conditions.

A second issue that the Eroski decision does not address is whether the refinancing agreement at hand should be (and actually was), on the face of it, viable. However, the *prima facie* viability of the refinancing plan was, as we said above, a key assumption in the Petromiralles decision.

Finally, the Eroski decision leaves open the issue of to what extent dissenting syndicated creditors can challenge a refinancing agreement that has been voted by the required majority. However, the prevailing view is that dissenting syndicated creditors that have been dragged by the required majority have nonetheless the right to challenge the court decision approving the refinancing agreement. This is also the view of the Madrid commercial courts (see the guidelines issued in November 2014).