A new regime for the refinancing of distressed companies

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Last March 7 the Spanish Cabinet approved a royal decree-law (the RDL) introducing urgent measures regarding the refinancing of distressed companies. The RDL, already in force, provides legal support to companies that are viable economically but not financially. Its aim is to allow these companies to restructure out of court, avoiding formal insolvency proceedings, given that, in practice, the latter tend to end up in the liquidation of the business.

The RDL reforms a number of sections of the Spanish Insolvency Act (SIA) and also deals with (i) the tax regime of extensions, reductions and conversions of claims into equity, to make them neutral for both the company and the creditors, (ii) the rules on tender offers following the conversion of claims into shares in a public company, to automatically exempt these cases from the obligation to make a compulsory offer, and (iii) the rules on accounting provisions resulting from the impairment of real estate assets, which will not be taken into account as regards 2014 annual accounts for the purposes of the minimum ratio between net assets and share capital that all companies must meet.

However, this note focuses on section 5 *bis* and additional section 4 (AS4).

Section 5 *bis* of the SIA

A company that cannot pay its debts regularly must file a petition for voluntary insolvency within two months, as otherwise its directors can be held liable and any creditor can file for compulsory insolvency proceedings.

However, as an alternative, the company can also start negotiations with its creditors with a view to restructure its debts in a way that resolves the insolvency or to pre-agree an arrangement which will eventually be put forward for vote within formal insolvency proceedings. This has to be done within three (plus one) months from the date of the so called *section 5 bis notice*.

Negotiations with creditors pursuant to section 5 *bis* will be kept confidential upon request from the debtor.

Section 5 bis notice prevents both director's potential liability for a late petition of insolvency and the compulsory declaration of insolvency. However, until the passing of the RDL, section 5 *bis notice* did not allow to impose a stay on enforcements by dissenting creditors, let alone extensions or reductions of the amount of their claims.

Stay of enforcements

Now, a *section 5 bis notice* will result in an automatic (i.e. no court decision is required) stay of enforcement actions, **which in practice amounts to a legal, compulsory stand still**:

- Generally, actions foreclosing on assets that are necessary to the business will be suspended. The question here is how to determine if an asset is necessary to the business. The SIA does not clarify this point, but in practice it is likely that, *ad cautelam*, courts do not grant leave to enforcement when the debtor claims that the relevant asset is necessary to its business.

- Provided a majority of at least **51 per cent** of the financial claims is obtained, all other types of enforcement by financial creditors, regardless of whether or not they affect assets that are necessary to the business, will also be suspended.

Enforcement of public law claims will not be subject to stay in any case.

Imposing refinancing agreements on dissenting creditors

Under the new AS4, certain refinancing agreements (those regulated in section 71 *bis*) can be imposed on financial dissenting creditors, including secured ones, provided the appropriate majorities are obtained.

The legal term *financial creditor* includes not only banks, but generally any type of creditor of a financial nature, as opposed to trade and public law creditors. Therefore, bondholders, funds, etc. are considered financial creditors for these purposes.

A majority of **60 per cent** of the aggregate financial claims can impose an extension of the maturity of **non-secured financial claims** of up to five years and their conversion into participating (and subordinated) loans with a tenor of up to five years.

A majority of **75 per cent** of the aggregate financial claims can impose an extension of the maturity of **non-secured financial claims** of up to ten years, a reduction of the amount due (the law does not set any maximum haircut), the conversion of claims into participating (and subordinated) loans with a tenor of up to ten years, and even the assignment of the debtor's assets or rights in payment of its financial claims.

Secured financial claims can also be crammed down according to the above, but only up to the extent their claims are not covered by the actual fair or market value of their collateral, as determined (as regards real estate assets) by an appraisal company, which can be chosen by the debtor at its own discretion among those that are certified by the Bank of Spain.

It is even possible to cram down secured financial claims also as regards the parts of them which are actually covered by the fair value of their collateral:

- As regards extensions of the maturity of up to five years or their conversion into participating (and subordinated) loans with a tenor of up to five years, provided **an additional majority of 65 per cent** is obtained, and

- As regards extensions of the maturity of up to ten years, reductions of the amount due, conversions into participating loans with a tenor of up to ten years and assignments in payment of debtor's assets or rights, provided **an additional majority of 80 per cent** is obtained.

To be sure, these majorities are in addition to those referred to all financial claims (60 and 75 per cent), and are calculated by reference to the aggregate amount of the parts of all financial claims that are actually covered by the fair value of their respective collaterals.

Syndicated lenders will be deemed to support the agreement, as regards the total amount of the syndicated loan, when a **75 per cent** of them vote in favor, except when the contractual provisions governing the syndicate require a lower majority, in which case the latter will prevail. This is to say that the relevant majority within the syndicate will determine the affirmative vote of all of the syndicated lenders for these purposes.

It is important to note that these financial arrangements require not only the above majorities of financial creditors, but also the consent of the debtor company, **which means that creditors cannot impose them to the debtor company**. However, directors of the debtor company can be held liable in case they veto, without reason, a conversion of financial claims into equity that has the support of the required majority of financial creditors.

In addition, these financial agreements need to be sanctioned by the court, but the court's involvement is limited to confirming that the above majorities have been met.

Finally, the court can also order the cancelation of seizures on the debtor's assets.

Super seniority of providers of new funds or *fresh money*

New funds provided to the debtor before March 9, 2016 within the framework of a refinancing agreement pursuant to section 71 *bis* or to AS4 will qualify as estate claims or super senior claims in case the company is declared insolvent within two years from the date they have been provided.

This applies also to additional funds provided by persons or entities related to the debtor company, except when they are provided as equity.

Interest accrued on this type of additional financing will, however, be considered subordinated claims.

Jesús Almoguera