New restructuring regime in Spain

Bernardino Muñiz focuses on the most ground-breaking amendment introduced in the Spanish insolvency system, namely the pre-insolvency agreements and the effects of its endorsement by the court

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THE REFORM INCLUDES A SET OF PROVISIONS REGARDING PRE-INSOLVENCY SOLUTIONS

On 22 September 2011 the Spanish Congress finally approved the Reform of the Spanish Insolvency Law (the "**Reform**"). The intended purposes of the Reform are to speed up insolvency proceedings, to professionalise the insolvency practitioners' activity and to encourage refinancing agreements.

In this article we will focus on the new provisions by means of which the Spanish legislator intends to foster refinancing agreements and, as a consequence, to reduce the number of insolvency filings.

The Reform includes a set of provisions regarding pre-insolvency solutions which are aimed to promote agreements with creditors that might put an end to the debtor's existing or imminent insolvency situation and would avoid having to file an insolvency petition. These agreements seek to alleviate the excessive workload of Commercial Courts and, at the same time, to avoid the reputational damage that the insolvency declaration always entails.

Pre-insolvency communication

On one hand the Reform devotes a specific provision to pre-insolvency communication, which may be used not only to renegotiate the acceptance of an early creditors agreement proposal, but also to try to reach a refinancing agreement. If the insolvency situation is resolved by means of the refinancing agreement, it will not be necessary to file the petition for insolvency at the end of the pre-insolvency period. This solution was already accepted in practice by the Spanish Commercial Courts. Therefore the modification is purely a technical improvement and does not resolve the main difficulty that arises in pre-insolvency negotiations, which is the creditors mistrust about contracting with a debtor whose insolvency has been formally acknowledged. In spite of the Reform now permitting to perform a pre-insolvency communication in cases where the insolvency is only imminent, the fact is that financial institutions have more difficulties to obtain internal approval for refinancing agreements when the debtor has publicly recognised that it is undergoing financial difficulties.

Instead of putting pressure on the creditors to agree to a debt restructuring due to the imminence of the insolvency filing, the pre-insolvency communication tends to have the opposite effect and makes it more difficult for professional creditors to participate in whatever restructuring scheme is proposed.

It would have been more helpful for the intended purpose of the Reform to set up an extension of the term to file a voluntary insolvency petition, together with the possibility of lodging opposition against the petitions for compulsory insolvency (requested by the creditors), without the classification as voluntary insolvency being compromised if the debtor proves he was negotiating a pre-insolvency agreement. Such classification is important for the debtor in order to remain in possession throughout the insolvency proceeding (unless the company goes into liquidation).

Protection of refinancing agreements against claw-back actions

On the other hand, the Reform systemises the requirements for pre-insolvency agreements to become ironclad against claw-back actions. The claw-back risk of such agreements is that the Insolvency Practitioners might argue that their main aim was not to restructure debts but to grant additional securities to pre-existing obligations (which is one of the typical cases in which claw-back actions are in order).

In line with the existing regulation (introduced in 2009), those pre-insolvency agreements which entail the lending of "new money" in significant amounts or a significant novation of the payment terms, in accordance with a viability plan for the company, will be ironclad against claw-back actions in case certain formal requirements are also met.

The Reform specifies that it is enough that such requirements have been met before the declaration of insolvency occurs, and not necessarily at the time the agreement is signed. It is an important novelty, given how difficult it is to comply with the formalities required by the Spanish Insolvency Law before signing the agreement, when the debtor is in dire financial straits. The requirements currently necessary to reach the refinancing agreement, which remain

THE REFORM PERMITS TO IMPOSE PRE-INSOLVENCY AGREEMENTS ON DISSENTING CREDITORS

applicable after the Reforms are:

- Creditors (financial and non-financial, secured and unsecured) representing more than 60% of the company's liabilities support the refinancing agreement.
- The refinancing agreement is favourably evaluated by an independent expert appointed by the Commercial Registry.
- The refinancing agreement is executed in a public deed.

The second of the above mentioned conditions is the most time-consuming and, as a consequence, has been the most difficult to comply with before the performance of the refinancing, especially in those rather frequent cases in which the refinancing is urgent in order to avoid debt enforcement actions from creditors not involved in the refinancing that might compromise the future of the financially distressed company (by seizing a key piece of machinery for the industrial production of the debtor for example).

It is indeed positive that the evaluation of the refinancing agreement by the independent expert can now be obtained after the refinancing agreement is already in force, although the effect of this provision is yet to be seen in practice. This is due to the fact that the creditors involved in the refinancing normally want to make sure that the evaluation will be positive to avoid the risk of having performed an agreement that turns out not to be fully ironclad due to the lack of the one legal requirement that is most decisive in proving that the refinancing operation was not detrimental, in case the debtor ends up having to file for insolvency within the claw-back period (two years prior to the date in which the insolvency is formally declared by the Commercial Court).

Court endorsement of refinancing agreements and limited cram-down of dissenting creditors

The Reform adds the possibility of requesting the endorsement of the refinancing agreement, provided that it meets the basic legal requirements stated in the previous section and that, in addition, the agreement is supported by professional creditors who hold 75% of the debt owned by financial institutions. In that case, and only if it does not imply a disproportionate sacrifice for the rest of the financial institutions, the agreement will be enforceable against dissenting creditors.

This is arguably the most ground-breaking provision the Reform has introduced since it allows to extend some effects of a creditors agreement to financial entities that have not supported it, without having to file an insolvency proceeding. Until the reform came into force cram-down provisions were only applied within the insolvency proceeding itself.

However, the Spanish legislator has been rather shy in its move towards approaching the court endorsed refinancing agreements to the English schemes of arrangements (that some important Spanish companies have benefited of in the recent past). As a matter of fact, the endorsement of the refinancing agreement and its extension to dissenting creditors only affects the waiting periods agreed with financial institutions, not the other points of that agreement (e.g. margins improve, capitalisation of interest, obligations for doing or refraining from doing).

Besides, the waiting period that might be imposed on dissenting creditors is limited to

> THE REFORM INTRODUCES IMPORTANT PROVISIONS IN RELATION WITH "NEW MONEY" LENDING

three years, and will only affect financial institutions which claims are not secured (by means of a special preference over certain assets). Such limitation will undoubtedly reduce the applicability of the cram-down provisions.

In addition to the above-mentioned limitation the Reform provides two mechanisms to protect dissenting creditors:

- They may challenge the judicial endorsement of the refinancing agreement by means of an abbreviated proceeding. The proceeding might only be initiated once the agreement has been endorsed, so it will not affect the endorsement process. The grounds of the challenge may only refer to the required percentage of supporting creditors or to the existence of a disproportionate sacrifice for dissenting creditors.
- Dissenting financial institutions affected by the judicial endorsement will keep their rights against those severally liable with the debtor and against its guarantors.

Another truly ground-breaking provision introduced by the Reform has to do with the possibility of obtaining a one month freeze of enforcement proceedings in progress which could impede the refinancing operation in case a refinancing agreement has been reached and its court endorsement has been requested by the debtor. Prior to the Reform only the declaration of insolvency enabled the debtor to freeze enforcement actions against it.

The combination of the cram-down provision and the freezing of actions entails that if the endorsement is finally granted by the Judge, the freezing of foreclosure proceedings brought up by financial institutions might be extended during the entire waiting period included in the refinancing agreement, which cannot exceed three years.

Preferential treatment of new money

In addition to the previous measures related to refinancing agreements, the Reform introduces important provisions in relation with "new money" lending, with the aim of encouraging the acceptance of those refinancing agreement proposals which require additional financing by the creditors.

The Reform ranks as claims against the estate 50% of the new money obtained by means of a refinancing agreement and grants a general preference (over ordinary claims) to the remaining 50%. Before the reform came into force granting in rem securities for the new money was the only way to ensure that it would not be ranked as an ordinary debt (and be subject to the haircuts that might approved by means of a creditors agreement) in case the debtor ended up filing for insolvency in spite of having restructured its debt in the recent past.

New money lending is also fostered within the insolvency proceeding since, the Reform ranks as claims against the estate the total amount of new funds provided to the debtor in the context of a creditors agreement in case it ends up in liquidation (due to the breach of the creditors agreement payment obligations).