

# Court Approval of Refinancing Agreements in Spain

José María Mesa Molina & Alberto Álvarez Marín analyse the approval system and offer a critical view of the insolvency law

**The 4th Additional Provision of Law 22/2003 of July 9, on Spanish Insolvency (the “Insolvency Law”) regulates one of the main pre-insolvency instruments existing in Spanish law: court approval of refinancing agreements between a debtor company and its creditors.**

As with other mechanisms of this nature, the legislature has tried – especially in the current economic crisis – to facilitate refinancing agreements between a debtor company and its creditors through court approval, with the primary goal of ensuring the economic viability of the debtor company and avoiding the need to carry-out an insolvency procedure that, in most cases, inexorably leads to the final winding-up of the company.

Perhaps the most important aspect of this “anti-insolvency” mechanism to highlight is the possibility of extending certain effects of the refinancing agreement (stay and reduction of debt, among others) to the so-called “dissident creditors”, i.e. those creditors who have opposed or have not signed the refinancing agreement, contingent on certain majorities of financial liability thresholds being met, as discussed below.

Thus, the law attempts to prevent the opposition from creditors owed minor amounts that could pose a serious obstacle to the continuation of the debtor company. This is the direction taken by the latest reforms undertaken on court approval – such as Law 17/2014, of September 30, which adopted urgent measures on debt



refinancing and restructuring of debtor companies – that have tended to favour creditors who have signed a refinancing agreement at the expense of dissenting creditors.

This article analyses the fundamental aspects of court approval of refinancing agreements (requirements for court approval, court proceedings, effects, challenges, etc.) and offers a critical view of this mechanism.

## Requirements to apply for court approval

The legal requirements to obtain

court approval of a refinancing agreement are the following:

- (i) The agreement should be signed by creditors representing at least 51% of the financial liabilities.
- (ii) The agreement should lead at least to a significant expansion of the available credit or the modification or termination of the debtor’s duties, provided that the debtor meets a viability plan which allows the continuation of professional or business activity in the short and medium term.
- (iii) A certificate from the debtor’s auditor certifying the



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**ONE OF THE MAIN PURPOSES OF COURT APPROVAL IS THE POSSIBILITY OF EXTENDING CERTAIN EFFECTS OF THE REFINANCING AGREEMENT TO CREDITORS OPPOSED TO THE AGREEMENT**



- compliance with the financial liabilities' percentage required in order to adopt the agreement.
- (iv) The agreement must be formalised in a public document.

**Effects of court approval of a refinancing agreement**

Court approval of a refinancing agreement has the following main effects:

- (i) The extension of certain effects of the refinancing agreement to dissident creditors, depending on the percentages of approval of the agreement.
- (ii) The paralysis of the enforcements brought against the debtor for the debts related to the refinancing agreement.
- (iii) The inability to claw back the agreement if refinancing leads to subsequent insolvency proceedings.

**Effects extending to dissenting creditors**

As noted, one of the main purposes of court approval is the possibility of extending certain effects of the refinancing

agreement to creditors opposed to the agreement. Under the Insolvency Law, the percentage of the financial liability affected by the agreement determines which effects of the agreement extend to dissident creditors.

When the agreement has the support of creditors representing 60% of the financial liability (65% for creditors whose claims are secured by collateral) the following effects of the agreement may be extended to the dissenting creditors:

- (i) Forbearance of principal or interest payments for up to five years.
- (ii) The conversion of debt into equity loans during the same period.

When the agreement has the support of creditors representing 75% of the financial liability (85% for creditors whose claims are secured by collateral) a greater variety of effects may be extended:

- (i) Forbearance of principal or interest payments for a term of five years or more, but in no case more than ten.
- (ii) Debt pardons.
- (iii) The conversion of debt into shares of the debtor company.
- (iv) The conversion of debt into

equity loans, convertible bonds or subordinated loans, or other similar instruments.

- (v) The transfer of property or rights to creditors as payment of all or part of the debt.

**Procedure for obtaining court approval**

The procedure articulated by the Insolvency Law to obtain court approval of a refinancing agreement is particularly characterised by its speed, which attempts to resolve a situation of actual or imminent insolvency that may force a company to end its economic activity by filing for insolvency. The main steps of this procedure are as follows:

- (i) Application for court approval of the agreement addressed to the competent court where the debtor company or any signatory of the financing agreement has its registered office, accompanied by certain documentation (e.g, refinancing agreement and certified auditor, among others).
- (ii) Having examined the documentation, the judge will decide whether the application is admissible.

- (iii) After full satisfaction of the legal requirements provided above, the judge shall automatically approve the refinancing agreement, without going into the merits, within fifteen days. The Court order shall be published in the Insolvency Public Register and the Spanish Official State Bulletin (BOE).

### Challenging court approval

Although it is certainly restrictive, the Insolvency Law allows dissident creditors to challenge the court approval of a refinancing agreement. Dissident creditors may only allege (i) the disproportionate nature of the sacrifice required from the dissident creditors; and (ii) the failure to meet the legally required majority of financial liability.

In relation to the first ground, the Insolvency Law only refers to the disproportionate sacrifice very generically. Looking into Spanish doctrine and case law, determining the existence of a disproportionate sacrifice requires (i) an assessment of the effects of the agreement for dissident creditors compared to the effects on signatories; and (ii) an appreciation of whether the planned restructuring limits the rights of the dissenting creditors more than they could reasonably expect in the absence of a restructuring.

The second reason for challenging court approval concerns whether the refinancing agreement meets the legally required majority for approval (51% of creditors) and, where appropriate, the extent of the agreement's effects (from 60% up to 85%, depending on the case).

In challenging the court approval, dissenting creditors may be unsure about the period available to raise the challenge. The Insolvency Law refers merely to a period of fifteen days as of the publication of the Court order, but does not clarify whether it is fifteen business or

calendar days.

In this regard, it should be clarified that the 15 day period is a procedural term which therefore should exclude non-working days (Article 185 of the Spanish Law of the Judiciary). This is due to the fact that the period to challenge begins to run as a result of a procedural action, which in this case is the publication of the order in the BOE and in the Insolvency Public Registry according to the Spanish Supreme Court's case law.

Despite not being an actual judicial notice, the "publication" is undoubtedly a procedural notification form which the Insolvency Law chooses precisely to expedite the process and avoid possible delays arising from the difficulties of communication to each of the dissenting creditors.

Lastly, the steps to successfully challenge are explained in the following points:

- (i) The challenge should be initiated before the same court that approved the agreement.
- (ii) If the judge in charge of the challenge deems it appropriate, the judge shall notify the challenge to the debtor and the other signatory creditors so that they may oppose the challenge within ten days.
- (iii) The judgment ruling on the challenge of the court approval must be issued within thirty days.

### Conclusion

As noted at the beginning of this article, the Spanish insolvency proceedings end in a high percentage of cases with the winding up of the debtor. Therefore, the pre-insolvency phase – specifically with court approval of refinancing agreement – stands as one of the determining factors in achieving business continuity in a critical financial situation, by setting up new instruments, amortisation repayment instalments, and financial conditions more in line with the market, in addition to providing refinancing agreements

of a significant level of legal protection against third parties (e.g. dissident creditors).

That being said – and without losing sight of the advantages that this institution offers – the current legal configuration of this provision cannot be ignored as some of its other key aspects are detrimental to minority dissenting creditors.

According to the latest legislative reforms in Spain, given the urgency of judicial proceedings, the current approval process leads to a "quasi-automatic" refinancing agreement (at a first stage, the Court does not evaluate the existence or not of disproportionate sacrifice, reducing the process to the fulfilment of mere formalities) with a very short period and reduced reasons for its challenge.

The burden of pleading the invalidity of the refinancing agreement, however, falls exclusively on the dissenting creditors. This situation is aggravated by the fact that the creditors in question are not personally notified of the court's decision or of the short time frame they have to appeal the decision (fifteen days).

Most major critics are sceptical that any challenge to the court's approval would be filed before the same court that made the decision, and that appeal would be possible *vis-à-vis* an independent body. This leads to a certain degree of helplessness on the part of the dissident creditors (considering that it is a rather complex task for a judge to rule against his/her own decision and change the conclusion thereof).

Thus, the legitimate and necessary objective pursued by the legislative body to ensure the viability of the Spanish companies could have been also achieved in a fairest way and reasonably preserving the rights of dissenting creditors, who also play a key role in financing the debtor. ■



**MOST MAJOR CRITICS ARE SCEPTICAL THAT ANY CHALLENGE TO THE COURT'S APPROVAL WOULD BE FILED BEFORE THE SAME COURT THAT MADE THE DECISION**



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