Judicial consideration of the Schemes of Arrangement

Carlos Nieto considers the initial outcomes of the first Schemes of Arrangement in Spain

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The significant changes brought to Spanish insolvency law and introduced in the latest legislative session have been firmly directed at promoting schemes of arrangement as a measure to prevent corporate insolvency.

The previous edition of this journal has already analysed the most salient features of Spain's new regime for refinancing after the adoption of the Royal Decree-Law 4/2014 and Law 17/2014.

High levels of debt

After more than a decade of application of the current Law 22/2003 on Insolvency, the Spanish insolvency proceedings conducted in commercial courts have proved excessively long and costly. This factor, however, has not determined their failure to serve as a corporate life jacket. Instead, there is a much stronger case for attributing the failure to the compounded resistance of debtors in Spain to legal insolvency proceedings.

Thus, according to official statistics, when companies finally decide to seek a declaration of insolvency, their condition is usually very serious or practically irreversible: in 2014, 77.98% of the bankruptcies had a level of debt that made it impossible to pay off all their debts in less than 25 years, worse figures than those for 2013 (77.12%), 2012 (73.2%), 2011 (72%) and 2010 (66.6%). The deterioration in corporate finances caused by this postponement has meant that every year the percentage of companies that become insolvent with positive operating results has got smaller and smaller (in 2014 only 29.91% compared to 30.85% in 2013, 36.56% in 2012, 39% in 2011 and 43% in 2010).

Viable alternative

It became essential to offer an effective viable extrajudicial alternative to the meeting of creditors that would enable decisive and above all timely action to deal with companies' financial difficulties.

In the light of the initial outcomes from the application of the reforms, that objective has certainly been achieved: between 2014 and 2016 schemes of arrangement have been judicially approved for major firms like Metrovacesa (Commercial Court No. 3 in Madrid, decision dated 24.6.2014), Fomento de Construcciones y Contratas (Commercial Court No. 10, Barcelona, decision dated 12.1.2015), Sacyr Vallehermoso (Commercial Court No. 7, Madrid , decision dated 12.2.2015), Realia (Commercial Court No. 1, Madrid, decision dated 1.3.2016), and very recently, Abengoa (Commercial Court No. 2, Seville, decision dated 6.4.2016).

Other major refinancings are currently in progress and being followed by the financial press minute by minute, almost like the broadcast of a sporting event (the most recent case being the construction company Isolux).

Consequently, without being overly optimistic, it can be predicted that mega insolvency proceedings in Spain, at least as regards major firms, are now a thing of the past. Major banks undoubtedly prefer to assume major losses outside insolvency proceedings with a speedy, controlled solution rather than running the risk of a long receivership and an uncertain outcome. The foreseeable increase in judicially approved schemes of arrangement and their increasing complexity are the reason why four Commercial Courts in Madrid now specialise exclusively in this type of proceedings (soon to be increased to six courts).

It is worth, however, considering whether or not it is a good idea that the tool which prevents and avoids filing for composition proceedings (to which Law 22/2003 dedicates a total of 226 articles) should continue to be regulated by a single, 13-point Additional Provision to the Law.

Legal uncertainty

The extreme brevity and conciseness of the legal framework meant that the commercial courts in the cities where most of the operations are concentrated had to publish sheets of criteria (like, for example, those published by the Madrid commercial courts on 7 and 21 November 2014).

These criteria show a well-intentioned attempt to remedy the legal uncertainty caused by the lacunae, but they may cause some perplexity to foreign operators from the perspective of the hierarchy of laws, especially when they can be changed or clarified without advance notice (thus for example, the Explanatory Note from the Commercial Judges in Madrid dated 20.1.2015 on the position of holders of financial guarantees in the approval of

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schemes of arrangement).

Many procedural problems arise over approval proceedings for schemes of arrangement approval proceedings, especially when the affected creditors object (initiating a single objection procedure or the formation of several with subsequent accumulation, summonsing all the creditors who have joined the agreement or only the debtor and publication of the objection, with the possibility of other interested creditors appearing) and in the case of non-fulfilment of measures agreed by one or more affected creditors.

Reforms

From the substantive perspective, however, (undoubtedly the one of most interest for operators involved in refinancing operations) there are three issues which need clarifying in the applicable legislation and a couple of points which should probably be the object of reforms.

The necessary clarifications in the legal text concern firstly the type of measures considered in a scheme of arrangement which can be imposed on dissenting and absent creditors. The text of the Fourth Additional Provision contains a short list of these measures (reductions of debt, debt moratoria, debt to equity conversions or shareholder loans, dation in payment), but it does not specify whether the list is closed or whether other possibilities are also acceptable (maintaining bill discounting facilities, establishing new guarantees, waiving existing ones, etc.), and contradictory judicial decisions have been handed down in this regard.

Secondly, it is also doubtful after reading the legal text whether the measures should be the same for all types of creditors, or whether differences should be made between different categories of debts and whether the measures should be imposed asymmetrically.

Thirdly, it is uncertain whether refinancing operations should include all the debtor's liabilities or whether there can be partial refinancing. This is a key issue because the requirement for certain majorities in order to impose agreements on dissenting parties may promote fraudulent actions if the debtor is allowed to set the boundary of the refinanced liabilities (a sort of gerrymandering).

Conclusion

To conclude, the necessary legal reforms should include the possibility of granting extraordinary extensions to the short deadlines imposed for negotiating agreements (currently, stopping foreclosure and applications for involuntary bankruptcy only last four months: an excessively short period for complex refinancing with highly fragmented liabilities and the presence of foreign banks).

Such extensions could require guarantees from a significant percentage of financial creditors as proof of their seriousness and to prevent undue delay.

And finally, changes in competences should be introduced so that the commercial courts could hear any disputes that may arise over the interpretation of refinancing agreements and their enforcement. These disputes are currently dealt with by non-specialised civil organs, which may hinder harmonised application of the legal framework. ■