December 2012

Inside Story: Spanish scheme of arrangement

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Spanish scheme of arrangement is starting to work

1. INTRODUCTION

The last comprehensive reform of the Spanish Insolvency Act, which was published in October 2011 and entered into force in January 2012, introduced a similar mechanism to the English scheme of arrangement.

It consists of the possibility for a debtor company to request the Court to impose to all dissenting or non-signing unsecured financial institutions some provisions (basically, the agreed payment extension) of the refinancing agreement entered into by other financial institutions that hold at least 75% of debtor's liabilities with financial creditors at the time the agreement is entered into, provided that it does not impose a "disproportionate sacrifice"to the dissenting financial institutions.

According to the Spanish Insolvency Act, the refinancing agreement of such "schemes" must comply with the same requirements imposed for the protection as those other refinancing agreements which just aim to be a safe harbour against claw back attacks, and which are basically three requisites detailed hereunder: (i) it must significantly increase the funds available to the debtor, or extend the maturity date of the financial agreement, or establish new obligations which replace existing ones; (ii) it must also be supported by a viability plan (assessed by an independent expert) which allows the continuation of the business in the short and medium term; and finally (iii) the refinancing agreement needs to be approved by creditors of any class (i.e. not necessarily financial institutions) who hold at least three-fifths of total debtor's liabilities at the time the agreement is entered into. Nevertheless, it is defended by some legal authors (and it has been confirmed by some judicial resolutions, as we will see below) that this last requirement under point (iii) must not be required for the application of the "schemes". It can be alleged, and we fully agree with this interpretation, that there are no grounds to require the favourable vote of creditors who are not going to be affected by the refinancing agreement and by its imposition by the Court.

Finally, the Court may also impose, at the request of the debtor, a stay on enforcement actions for a maximum period of one month, while the scheme proceedings are being resolved.

The recognition in other jurisdictions of schemes of arrangement authorized in Spain is an issue which, as in the case of U.K. schemes of arrangement, cannot be resolved through the Insolvency Regulation, as pre-insolvency proceedings are not included within its scope. As long as the Insolvency Regulation is not amended with the aim to extend its scope (as it is being demanded by several practitioners), it will be necessary to go to the Council Regulation 44/2001 on Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters. Nevertheless, there are some doubts also on the possibility of application of this Regulation for schemes of arrangement. Some commentators defend that, despite the wide scope of the term “judgement” in article 32 of the Regulation 44/2001, the court resolution authorizing an English scheme of arrangement could not be included within its scope because these proceedings have not the typical necessary adversarial nature which must be required and, therefore, are not “judgments” stricto sensu.

With regard to Spanish proceedings for the legal authorisation of schemes of arrangement, although there are certain similarities to the English system, we believe that there is a key difference with respect to the U.K. system which could be used to defend the possibility of direct recognition in other jurisdictions of Spanish scheme of arrangement resolutions. Thus, although it is true that creditors do not have the opportunity to make allegations prior to the issuance of the Court resolution, the Spanish Insolvency Act allows dissenting creditors to challenge the scheme of arrangement before the same Court which has previously sanctioned it. We believe that the possibility for all the interested parties in the proceedings to make allegations through this appeal allows the interpretation that these proceedings have the required adversarial nature.

In any case, we will see how it is resolved in practise by Courts, as for the moment we do not have knowledge of any resolution in which such issue has been discussed.

2. THE CASE

In autumn 2012 the company C reached a “scheme” with some of its financial creditors (which represented more than 75% of liabilities with financial institutions). The “scheme” consisted, basically, on the following terms:

a) The granting of a new loan for the cancellation of existing unsecured due debts which have their origin, mainly, in working capital facilities.

b) The granting of new money. The expiration date of both loan agreements was extended to June 2017.

c) The granting by C of in rem security in favour of the financial institutions which entered into the refinancing agreement.

The scheme complied with all the requirements provided by Spanish legislation for the imposition of the agreement to the dissenting financial institutions (i.e. the threshold of 75% of financial liabilities; the increasing of funds for the debtor and the extension of the maturity date; and the assessment of the viability plan by an independent expert), except the execution of the agreement by creditors who hold, at least, three-fifths of the total liabilities of C.

Nevertheless, as it has been anticipated in the previous section, it is reasonable to support that the reference made in the Spanish regulation of schemes of arrangement to the requirements of the protection against claw back has to be understood as applicable only for the material requirements and not for this specific requisite, which could be interpreted as conflicting with the requirement of 75% of the financial liabilities. In our opinion, the requirement of the approval of the refinancing agreement by creditors which are not going to be affected by it is groundless and hinders the application of this measure (being an additional obstacle to the existing ones, which would be briefly analysed in section 3 below). This interpretation is supported by the last Court resolutions with regard to this issue (resolutions from Commercial Court (Juzgado de lo Mercantil) Nº 6 of Barcelona dated June 5, 2012 and Commercial Court Nº 3 of Gijón dated July 10, 2012).

C formally requested the competent Court to sanction the refinancing agreement in autumn 2012 and, therefore, to impose to all the dissenting financial institutions (which were all of them unsecured) the extension for the payment of their debts until June 2017.The Court resolution has not been notified yet but we are confident that the refinancing agreement will be sanctioned by the Court in the proposed terms.

3. WHERE ARE WE AND WHERE ARE WE MOVING TO?

The case is an example that the Spanish scheme of arrangement is starting to work. Nevertheless, Spanish regulation has certain limitations in comparison with other legislations (for instance, the U.K. scheme of arrangement) which, in practice, may hinder its application, above all in complex financial restructurings with sophisticated debtors and creditors. This is the reason why most practitioners have declared themselves, since the introduction of the scheme of arrangement in the Spanish Insolvency Act, in favour of its extension to secured creditors, debt reductions or other restructuring solutions such as subordination or debt for assets agreements.

We will see if further reforms are implemented in the future to adapt this restructuring tool to the needs of sophisticated debtors and creditors, becoming then more effective in practice. In the meantime, we have to celebrate the introduction of the scheme of arrangement tool in the Spanish Insolvency Act and try to make the most of it as a tool to achieve successful refinancing agreements which avoids debtors’ insolvency. This case is an example that, even with the abovementioned legal

limitations, Spanish companies are starting to use this restructuring tool as an alternative to the filing for insolvency.

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