C'M'S' Albiñana & Suárez de Lezo

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BANKING AND FINANCE ALERT

Refinancing agreements and their protection against claw-back actions after the reform of the Insolvency Law by the Royal Decree-law 4/2014

The Royal Decree-law 4/2014, dated 7th of March, adopting urgent measures on the refinancing and restructuring of corporate debt, has modified certain provisions of the Insolvency Law regulation in relation to refinancing agreements.

Although it could be said that almost all of the reform refers in some way to such agreements, the core of the regulation, which defines the requirements these types of agreements must comply with to be protected against insolvency claw-back actions, has remained pinpointed in article 71 bis.

The legislator has realised that the protection of refinancing agreements, which were subject to claw-back actions in the insolvency framework, is crucial in attempting to ensure that the debtor does not end up heading towards a liquidation process.

The fear that claw-back actions could damage the agreements reached in the refinancing framework of the debtor's bank debt, especially the security interests granted to the creditors, has heavily influenced its scope and content in recent years. On a more serious note, it has also put an end to the execution of many of these transactions which would have allowed viable companies to continue their activities, albeit temporarily free from the burden of excessive debt.

Another fundamental obstacle which hampered the success of many of these agreements was the insufficient regulation of their judicial approval. Therefore, it should be noted that the reform makes a significant attempt to facilitate the execution of agreements in which the financial creditors, supporting the risk of postponing the satisfaction of their credits, or even accepting their definitive reduction or conversion into equity, allow the debtor's scarce resources to be assigned to the commercial creditors, a basic need for business continuity. This is a sacrifice which the majority of creditors will not be willing to accept if, by contrast, it enables a minority of them to take advantage of such effort, being their credits still satisfied without improving the debtor's sustainability.

1. Protection against claw-back of refinancing agreements

Resistance against insolvency claw-back actions continues to be a focal point for refinancing agreements in the Insolvency Law reform. Only those which satisfy the necessary requirements to remain protected against the application of the claw-back provisions in the event of a subsequent insolvency will be able to benefit, additionally, from other effects within the scope of the insolvency regulation. As will be explained, this will not be the case for all of them.

In terms of the above, the regulation reform covers three aspects:

- Modification and simplification of the pre-requisites to achieve said protection in general.
- Creation of two new assumptions which allow certain agreements to remain protected.
- Reinforcement of the effects of said resistance.

1.1. Simplification of refinancing agreements' general requirements

Before the reform, in order to remain protected against claw-back actions, refinancing agreements in general required:

- Substantial support of the debtor's liabilities (3/5).
- A viability plan which allows continuity of activity in the short and medium term.
- The report of an independent expert on the sufficiency of the information received, the reasonable and feasible character of the viability plan and the proportionality of the security interests granted.
- The formalisation in a public document.

As a result of the modification by the Real Decree-law, the independent expert report is no longer a requirement, although does not disappear completely.

Therefore, any pre-insolvency agreements in virtue of those which "at least extends the available credit or entails the modification or cancellation of its obligations, either through extension of their maturity or the establishment of new obligations in their place", will remain protected upon compliance with the rest of the requirements mentioned above. Attention must be brought here to the inclusion of the reference to the cancellation of the obligations. As the explanatory memorandum recognises, the protection for refinancing agreements seeks to include an agreement on the transfer of assets and rights as payment, something which had been recognised by the tribunals.

A difference is introduced in the reference to the accreditation of the concurrence of the majority of the liabilities required to adopt the agreement. As a new feature, it will have to be endorsed by a certification from the debtor's auditor or, in its absence, one appointed for this purpose by the relevant commercial registrar.

Independent expert report after the reform

As already stated, the independent expert report has not been eliminated. On one hand, it remains possible to obtain one, on a voluntary basis, with the same content included before the reform – except the sufficiency of the information provided -, and can now be requested not only by the debtor but the creditors too. What has disappeared, however, is a major part of the regulation on the appointment of the expert by the registrar, who introduced the Entrepreneur Law just a few months ago, probably due to the report having been relegated to a secondary role.

Perhaps the underlying problem has been that, in practice, the reliability of these reports in terms of the company's viability was clearly questionable once it ended up in insolvency, bringing its usefulness into question. Becoming a voluntary requirement supposes that when the parties opt to provide it, it should reinforce the protection against claw-back actions and not just be a response to a mere formal compliance of a legally imposed condition.

The existence of an independent expert report is foreseen in certain events, although with varying scope:

- A favourable independent expert report would avoid, within a judicially approved refinancing agreement, the necessity of obtaining an exemption by the CNMV as regards the compulsory takeover bid directly arising from the acquisition, conversion or capitalisation of credits in shares of listed companies whose financial viability is in serious and imminent danger, whenever it deals with transactions carried out to guarantee the long term financial recovery of the company.
- The unreasonable refusal of credit capitalisation or the issue of convertible securities or instruments, if it prevents the reaching of a refinancing agreement as outlined in article 71 bis.1 or in the fourth additional provision, presumes the existence of gross negligence or wilful misconduct with the purpose of considering the insolvency as fraudulent. To that effect, it is foreseen that an independent expert report could declare the existence of a reasonable cause to capitalise.
- Lastly, it is also foreseen that an independent expert determines the value of the existing collaterals other than property or listed securities in the framework of judicial approval and with the objective of outlining the scope of its effects. Despite the remission of article 71 bis.4, this is limited to the regulation for his appointment, given that its content is clearly different to that outlined in said precept.

1.2. Protection assumptions

After the reform, three different possibilities exist for the protection of certain refinancing agreements against potential claw-back actions in the framework of the subsequent insolvency:

- In general, the agreements described in the previous section, subscribed by at least 3/5 of the liabilities.
- Certain agreements which do not demand any majority of creditors but other, stricter requirements in terms of the recovery of the debtor's assets
- Judicially approved refinancing agreements, for those which the undertaking of 51% of the financial liabilities is sufficient.

The requirements which must be bought together in each one of the highlighted assumptions are summarised below:

	General (71 bis.1)	Special (71 bis.2)	Judicially approved
Majority	3/5 of the liabilities	--	51% of the financial liabilities
Auditor certification	Yes	--	Yes
Significant increase of credit, modification or cancellation of obligations	Yes	--	Yes
Viability plan	Yes	--	Yes
Public document	Yes	Yes	Yes
Increase in the proportion of assets / liabilities	--	Yes	--
Current assets ≥ current liabilities	--	Yes	--
Non-increase in value of collateral / debt, with a limit of 9/10	--	Yes	--
Interest rate no higher than more than 1/3 to the previous	--	Yes	--

It should be highlighted at this point that for the new agreements outlined in article 71 bis.2 –actions, if we consider its wording-, the practical difficulty in assessing the concurrence of the two requirements – increase in the proportion of the assets over the liabilities and the current assets being higher than the current liabilities – given that in order to do it "all of the consequences of an asset or financial nature will be taken into account, including taxes, early termination clauses or similar, derived from the actions carried out, even when they occur with respect to non-participating creditors". Additionally, it must be considered that they will not be able to benefit from new security interests, and must even partially release some of them in order to comply with the requirement of 9/10 of the value of the collateral over the debt, as outlined in the explanatory memorandum. The assumption that they expect to replace some security interests with others will present more problems, as it will require the appraisal of both the pre-existing collaterals and those to be established, with the purpose of checking compliance of this requirement. In practice, it appears that the applicability of this article will be very limited.

We take into special consideration that another new development, the protection against claw-back actions of the judicially approved financing agreements, allows the protection of the agreements with the sole requirement that they are subscribed by 51% of the financial liabilities, irrespective of the proportion represented in the total liabilities of the debtor. Furthermore, the fact that approval is given via judicial proceedings should give more security to the executing creditors. As the judge has to give the approval when the outlined requirements are complied with, it appears more difficult that upon insolvency their concurrence, the sole grounds for challenging a refinancing agreement, could be discussed. On the other hand, the agreements covered by article 71 bis will not rely on this approval, even if a voluntary independent expert report has been requested. Due to that, its legal protection will always be at the expense of what can be questioned in insolvency proceedings, which should fundamentally be (i) the definition of refinancing agreement itself - which "at least extends the available credit or entails the modification or cancellation of its obligations, either through extension of their maturity or the establishment of new obligations in their place"-, or (ii) the existence of a viability plan that allows the continuity of activity in the short and medium term, with the rest of the conditions being relatively objective and, therefore, indisputable in an ordinary situation.

1.3. Effects of protection against claw-back actions

In the three types of protected agreements, the effects on them and the legal transactions, actions and payments, whatever their nature or form, and the collaterals granted in their execution are the same:

- As before, the exercise of claw-back and other challenging actions against the agreements only corresponds to the insolvency administration.
- However, the claw-back actions will now only rest on the non-compliance of the requirements for each type of agreement, which must be proved by the insolvency administration.

Due to that, as highlighted by the Royal Decree-law in its explanatory memorandum, the refinancing agreements that comply with such requirements will not be subject to the presumptions of financial detriment on the rest of the creditors even when they include assets disposals.

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2. Other effects of refinancing agreements

In addition to that pointed out, the refinancing agreements that comply with the aforementioned conditions, but not others, will be able to benefit from other advantages which should serve as a stimulus for their conclusion, and can be summarised in the following way:

- Their negotiation remains safeguarded by article 5 bis of the Insolvency Law. However, as will be explained in the corresponding alert, this has cut the debtor's possibility of making use of this protective mechanism against responsibility, which only applies if the agreements being negotiated are those outlined in the Insolvency Law, specifically the general agreements considered in article 71 bis.1 and their equivalents in the fourth additional provision, remaining outside those highlighted in article 71 bis.2.
- The inclusion in the refinancing agreements protected by law of debt capitalisation measures is favoured as a more desirable alternative to permanent debt release. For that:
  - The credits of creditors who have directly or indirectly capitalised all or part of them are excluded from being considered as subordinated credits.
  - A presumption of fraudulent insolvency is established in the event of opposition to such agreements by the shareholders without reasonable cause.
  - These measures are included within those that can be imposed on the dissenting creditors through judicial approval.
- The creditors will not be considered de facto administrators due to the obligations that the debtor takes on in relation to the viability plan, although it is possible to prove otherwise.
- 50% of the fresh money in the framework of the refinancing agreements is recognised as a credit against the insolvency estate, enjoying the remaining 50% of general privilege, in accordance with article 91.6 of the Insolvency Law, which erroneously maintains a reference to 71.6. However, said recognition as credit against the insolvency estate is temporarily increased to 100% of its amount for two years.
- Standard guidelines for the classification as a normal risk of restructured transactions as a consequence of a refinancing agreement have been established by the Bank of Spain, in their communication dated the 18th of March 2014, provided that objective elements confirm the probability of recovering the amounts owed after the agreement. For that, it will be especially relevant to evaluate the effect that the agreed debt releases, modifications to payment schedules or debt for equity swaps are going to have on the possibilities of recovering the amount owed, taking into account the debtor's viability plan.

If you are interested in obtaining additional information on the content of this Alert please contact:

Gracia Sainz - gracia.sainz@cms-asl.com
Abraham Nájera - abraham.najera@cms-asl.com
Beltrán Gómez de Zayas - beltran.gomezdezayas@cms-asl.com

CMS Albiñana & Suárez de Lezo, Calle Génova 27, 28004 - Madrid, España
T +34 91 451 93 00, www.cms-asl.com
