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2014 - 3

Banking and Finance alert

Royal Decree-law 4/2014: Restructuring and Refinancing of Corporate Debt

1. Introduction

On Saturday the 8th of March, the Royal Decree –law 4/2014, dated 7th March, was published in the Official State Bulletin, which adopts urgent measures in the subject of the refinancing and restructuring of company debt (the "**RD-L**"). Concealed under that name, in reality, is a new reform of the Spanish Insolvency Law ("**LC**") which means a further step towards progression out of the insolvency proceedings arena for companies going through periods of financial difficulty, in line with that initiated in 2009.

The new regulation reinforces the tools upon which both creditors and debtors relied to try to resolve these difficulties prior to proceedings, via extrajudicial agreements that may or may not be subject to court approval. As appreciated by reading the regulation, although the reform covers various aspects, the common link is the existing connection with refinancing agreements.

In line with a good number of legislation that surrounds us, the Spanish legislator appears convinced that the natural habitat of the agreements aimed at the preservation of companies is not insolvency, but the private negotiations in instances of, as it is called, pre-insolvency.

Below we offer a first approach to the content of the RD-L, which came in to force on the 9th of March. Its first reading leaves several unanswered questions, amongst those the transitional regulation.

2. Protection of refinancing agreements

The RD-L incorporates and reinforces certain measures which, in part, were already included in the LC, with the objective of fostering the negotiation and conclusion of the refinancing agreements, as well as protecting them from the risk of subsequent insolvency in which they could remain subject to the special termination regulation.

Pre-insolvency

Article 5bis LC, which permitted an extension to the period for filing for insolvency, in turn allowing the debtor to negotiate with its creditors, has been reformed to include a very powerful measure: that of anticipating at this stage the effects of declaration of insolvency by freezing the enforcement of security and judicial enforcements. It

prevents those creditors, who during the negotiation process have not adhered to a specific agreement on the suspension of legal action (stand still agreement), being able to execute such action and making the reaching of an agreement impossible. In this way: (i) it will not be possible to initiate or maintain judicial enforcements of assets which are necessary for the debtor to continue its corporate activity; and (ii) the creditors' financial liabilities will not be able to initiate or continue special enforcements, when 51% of the debtor´s financial liability has specifically supported the commencing of negotiations aimed at a refinancing agreement, whilst they have also committed not to initiate or continue with enforcements. For their part, creditors with security will be able to initiate their enforcement, but must remain temporarily freezed during the "pre-insolvency".

Protection against claw-back of refinancing agreements

The protection mechanism of the refinancing agreements is reinforced by an extension of the content of the old article 71.6 of the LC, which is now article 71bis. The regulation covers what type of refinancing agreements and under what conditions they would be protected from claw-back in the event of a subsequent insolvency. For this the following measures are considered:

a) The previous regulation for the protection of collective refinancing agreements remains substantially unchanged, with substantial support from the creditors (at least 3/5 of the debtor´s liability), but removing the need for an independent expert report, which is now optional. The report is substituted for a certification from the debtor´s auditor, limited to the liability needed for the adoption of the agreement.

b) It is now also included the protection of non-collective refinancing agreements (negotiated individually or together with various creditors) that, as a whole, improve the financial situation of the debtor in accordance with some legally fixed parameters (increase the proportion of asset/liability and current assets equal or superior to current liabilities). However, these refinancing agreements shall only be protected if certain limitations in the value of the security and the interest applicable to the refinancing are not surpassed.

c) In both cases, the possibility of commencing claw-back action lies exclusively with the administrator and can only be carried out due to an infringement of the requirements of article 71bis.

The conclusion of the refinancing agreements is also reinforced by a variety of other measures, some of which deserve highlighting below:

a) Although as a transitional step (only for the next two years), the legislator has recognised the characterization of credit against the insolvency estate any treasury granted to the debtor in the framework of refinancing agreements.

b) Benefit the conclusion of agreements that entail a capitalisation of credits, through different means, some of which are very new and will cause some minor interpretation difficulties.

- The capitalisation should not subordinate (parties especially related to the debtor) those who, originally being creditors, become shareholders. The drafting of the regulation is not very fortunate and creates certain doubts about the requirements that must be observed by the financer the escape the subordination regulation.
- It tries to ensure that the corporate resolution required for credit capitalisation, the issuance of securities or the creation of convertible instruments is not blocked by the shareholders. Therefore, a presumption of culpable insolvency is established in the event of the shareholders opposing to such resolutions without reasonable cause. Although the regulation brings up several interpretation problems, the mere probability of this result is undeniably significant.
- It is presumed that the creditors who subscribe to a refinancing agreement will not be considered as administrators de facto, which resolves some problematic scenarios.

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3. Judicially approved refinancing agreements

The RD-L carries out a detailed modification of the judicial approval system for refinancing agreements, through a new drafting of the 4th Additional Disposition of the LC.

This institution entails the possibility of imposing on all of the creditors with financial liabilities the refinancing agreements approved by a substantial amount of these creditors. In this modification, the following aspects stand out:

Firstly, the legislator keeps the approval regulation limited to a specific category of creditors, but avoiding referring to financial entities (a mention which generated controversy in the past). Therefore, the type of debt affected is now referred to as "creditors of financial liabilities". The approval system leaves out commercial creditors (unless adhered voluntarily) and those with public law liabilities.

- to protect against clawback risk;
- to ensure the extension of its effects to the dissenting unsecured creditors or secured creditors in the part which exceeds the value of the security; or
- to extend the effects to the dissenting secured creditors in the part which is covered by the value of the security.

It is noteworthy that against the traditional division (secured and unsecured creditors), the RD-L distinguishes between the real coverage of the relevant credit by the security, considering only as secured the part of the credit which is effectively covered by the value of the asset underlying the security, having such creditor(s) a real preference over the asset in respect of other creditors.

See below a summary table of the required majorities for the approval of a refinancing agreement and their corresponding effects:

Majority	Effects
51%	• This is the minimum threshold to access the judicial approval. • Protection of the refinancing agreement against clawback actions (if other requirements in article 71bis are met). • No imposition of effects on the dissenting or non-voting creditors .
60%	In addition to its protection against clawback: • imposition to dissenting or non-voting creditors (unsecured or secured for the amount exceeding the "value of the security") of the stay and/or of the conversion of senior debt into participative loans if agreed (both for a maximum term of 5 years). • The effects above will also extend to creditors who represent **65%** of secured amounts covered within the "value of the security": imposition to dissenting or non-voting secured creditors (for the part of the credit covered by the "value of the security").
75%	In addition to its protection against clawback: • imposition to dissenting and non-voting creditors (unsecured or secured for the amount exceeding the "value of the security") of: ◦ stay for a term longer than 5 years but not longer than 10 years. ◦ the partial release of the debt. ◦ the transfer of assets to the creditors in lieu of partial or total payment of the debt, and/or ◦ the conversion of debt into participative loans (for a term between 5 and 10 years), equity, convertible debt, subordinated loans, loans with capitalizable interests or any other financing instrument modifying the term, rank, or remaining conditions of the affected financial debt. • The effects above will also extend to creditors who represent 80% of secured amounts covered within the "value of the security": imposition to dissenting or non-voting secured creditors (for the part of the credit covered by the "value of the security").

Thirdly, the approval process also includes the automatic freeze of enforcements (not limited to one month, as was the case before this reform), or that to contest the approval the dissenting creditors can only argue that the required percentages have not been reached or the existence of a disproportionate sacrifice.

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4. Transitional Regulation

The transitional regulation is apparently simple: Any aspect which does not refer to refinancing agreements came in

to force on 9th March, whilst for the aspects related to refinancing agreement (which are the large majority), the regulation differentiates:

Subject	Applicable Regulation
Refinancing agreements yet to be initiated	The regulation established by the RD-L
Refinancing agreements already initiated	If negotiations are taking place under article 71.6 of the LC superseded by the RD-L, and the appointment of an independent expert has already been requested to the Registrar of Companies: the previous regulation to that established by the RD-L.
	If negotiations are taking place under article 71.6 of the LC superseded by the RD-L, without having requested the appointment of an independent expert to the Registrar of Companies: the regulation established by the RD-L.
	If negotiations are taking place under article 71.6 of the LC superseded by the RD-L, and the appointment of an independent expert has already been requested to the Registrar of Companies, but there exists an agreement between the parties to apply article 71bis.1 in the new draft of the RD-L: the regulation established by the RD-L.
Other cases	The regulation established by the RD-L

This transitional rules are open, however, to several interpretation issues which may be a cause of conflict in their application (could an enforcement be frozen by virtue of the new drafting of article 5bis of the RD-L, during a requested pre-insolvency period yet in-force? what happens with claw-back actions that are in in process?).

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