C/M/S/ Albiñana & Suárez de Lezo

BANKING AND FINANCE ALERT

REFINANCING AGREEMENTS AND OUT OF COURT PAYMENT AGREEMENTS UNDER THE SPANISH ENTREPRENEURS ACT

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1. Introduction

The long awaited Entrepreneurs' Act *(Ley 14/2013, de apoyo a los emprendedores y su internacionalización* PDF*)* was published on 28 September 2013 in the Official State Bulletin, entering into force the day immediately following.

In addition to the multidisciplinary regulation relevant to entrepreneurs, albeit remotely, the new Act introduces some new far-reaching reforms in the Spanish Insolvency Act, despite failing to reach the depth desired in some issues.

2. Pending clarifications regarding the judicial approval and appointment of independent experts

What is most striking from the new legislation is the amendment included in the 4th additional disposition of the Spanish Insolvency Act (together with the introduction of a new section 71 bis) due to, despite being dubbed "Supporting the financing of entrepreneurs", being entirely irrelevant to the actual purpose of the Act.

Although it manages to greater regulate the procedure before the Mercantile Registry necessary for the appointment of the independent expert who must certify the refinancing agreements which are governed by section 71.6 (also subject to adaptation), the above amendment has little impact beyond a few isolated elements and the greater clarification it gives to certain practical aspects which had previously been resolved by means other than the Spanish Insolvency Act and the Mercantile Registry Regulations. In its new form it expressly allows the Registrar to request various fee proposals of one or more suitable professionals before proceeding to his/her appointment, and also expressly allows for the possibility of requesting the appointment of the independent expert before closing the refinancing agreement and drafting a final viability plan.

In our opinion, the new wording of the point 1 of the 4th additional disposition is more noteworthy, not

only because it touches upon the judicial approval ("*homologación*") of the refinancing agreements and finally takes a position regarding the enforceability of a double majority, but because it represents a missed opportunity to have cleared up some other controversial issues regarding the judicial approval, which practical experience has been flagging up since its introduction in our legislation as an attempt to emulate the English scheme of arrangement. Although these issues are hardly related to entrepreneurs, given the divergent nature of the reform they could have been perfectly included.

There are welcome changes clarifying the requirements under 71.6 for the judicial approval of a refinancing agreement (now reduced to its execution by means of notarial deed and sign off by an independent expert), and a drastically reduced majority of 55% of the financial institutions creditors is required, which make it clear that a judicially approved refinancing agreement will not necessarily have protection against reintegration actions.

The reduction in the percentage of bank creditors required to be party to a refinancing in order for its effects to extend to the rest should further generalise use and foster the good outcome of restructuring processes previously hampered by the opposition of a minority. However, this reduction alone does not stop the restructuring processes from being affected by the gaps and inconsistencies of the 4th additional disposition, which has not been subject to any other changes.

There are still very basic uncertainties and gravely underdeveloped issues, such as what must be understood by the stay of payment in a refinancing agreement and what part of its effects will be imposed on the dissenting financial institutions, or exactly how the judicial approval affects those with security interests beyond potential enforcement processes, or the criteria to decide when a disproportion of efforts requested exists which would allow some creditors to escape the judicial approval effects. There will still be a great many court decisions that merely consider the refinancing agreement approved without further clarifications, whilst others will deny the approval by considering that there is no stay of payment in the agreement examined, to the puzzlement of the signatory creditors.

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3. The out of court payment agreement

The main change in the Act as regards prevention and restructuring is concentrated in the introduction of the new Title X in the Spanish Insolvency Act (and some related remarks scattered around other sections, such as 5 bis or 15.3, inter alia). The new provision is of limited scope but presents some interesting new aspects as well as creating confusion, as is the norm in this area.

The principal aspects of the so-called out of court payment agreement governed by Title X can be summarized in the following points:

- It consists of an out of court debt negotiation process with insolvent small business owners. Debtors who are natural persons with liabilities exceeding five million euros and legal persons with over fifty creditors or whose assets and liabilities exceed five million euros are excluded.
- The central figure shall be the insolvency mediator appointed by the Mercantile Registry or Notary Public before whom the corresponding application is presented.
- There are numerous exceptions, justified to a greater or lesser extent, that include that applications cannot be made if any of the debtor's creditors, who must be subject to the agreement, is declared to have entered into insolvency.
- It is incompatible with the negotiation of a refinancing agreement or an application for insolvency. This applies not only at the time of the opening, but the conclusion of an out of court payment agreement apparently rules out the possibility of future coverage by section 5 bis in the future or of applying for insolvency other than in the consecutive form mentioned here below, since the opening of the consecutive insolvency proceedings is almost automatic in case of breach.

Consequences of the opening of proceedings for the debtor and creditors:

- Once the application is filed, the debtor is forbidden from applying for a credit or a loan (we want to interpret this broadly in the sense of meaning any type of non-commercial financing, perhaps with the somewhat unclear intention of making the debtor's liabilities as stable as possible during the proceedings), and must return any and all credit cards held in his/her name and abstain from using any electronic payment system.

- The out of court payment agreement is considered as a new possibility within the section 5 bis of the Spanish Insolvency Act, meaning that as from the corresponding notice made to the competent court, the usual three month period will begin. During this period it is not mandatory for the debtor to apply for insolvency (with the consequential effects on its liability) and it creditors (section 15.3) may not do so either.
- Likewise, during this same period the debtor's creditors shall neither bring nor continue enforcements against his/her property or record seizures following the request to appoint an insolvency mediator, with the exception of those holding a security interest who, as will be seen, are not subject to the agreement unless should they wish to be at their own will. Notwithstanding the above, they may enforce guarantees provided by third parties.
- Furthermore, the creditors shall abstain from performing any act leading to improve their situation in respect of their common debtor during the proceedings.
- The major role of the insolvency mediator is to call the debtor and all his/her creditors who could be subject to the potential agreement (which excludes public institutions, the participation of the creditors with a security interest being voluntary) to a meeting in order to discuss and, if appropriate to approve, a repayment schedule for the outstanding credits.
- Such repayment schedule may include the transfer of property for payment of debt, debt relief of up to 25% and stays of payment of up to three years. The Act makes no additional provisions for the contents, the possibility that not all the creditors are equally treated or the consequences that such inequalities shall have over the majorities required to pass it.
- The creditors shall have the opportunity to make alternative proposals or change the repayment schedule before and even during the meeting, although without changing the aspects previously accepted by the non-attending creditors.
- In this respect, all potentially affected creditors shall attend the meeting or give their prior approval or refusal within ten days of receipt of the notice. Otherwise, their credits shall be subordinated in the event of consecutive insolvency proceedings.
- 60% of the votes of credit right holders shall be necessary to approve the agreement. If the payment via the transfer of property is included, a 75% majority will be required and the approval of the creditors holding security interests over the property transferred.

Effects of the agreement on the creditors:

- No creditor affected by the agreement may bring or continue enforcements against the debtor prior to the announcement of the procedure opening. Any seizures will be cancelled.
- As in other areas, the alternatives for the creditors with security interests who shall be excluded from the agreement, as regards the possibility for them to pursue the rest of the debtor's property not subject to their security interest (for example, after enforcing it in the event that it is not sufficient to pay his/her credit) are not clearly regulated.
- Creditors shall retain the actions at their disposal for the whole credits against those jointly and severally liable and the personal guarantors of the debtor, similarly to section 135.1 of the Spanish Insolvency Act within the scope of the arrangement of creditors, but not limited to the dissenting or unaffected creditors.
- The proceedings fail when a majority of the creditors resolves to refuse prior to the meeting, when an agreement is not reached or it is challenged or annulled or when the mediator certifies its breach thereafter. Such circumstances will give rise to the opening of the consecutive insolvency proceeding, which may be also applied for by the insolvency mediator.

Key characteristics of the consecutive proceeding:

- Unless just cause is given, the administrator of the consecutive insolvency proceedings shall be the insolvency mediator.
- The term of two years to identify the revocable acts is given as of the date of the debtor requesting appointment of the insolvency mediator. There is some uncertainty as to whether this means that acts occurring after such request and before the insolvency proceedings are declared will not be subject to the reintegration acts, which would not make sense. On the contrary, we find ourselves in a scenario in which, assuming a maximum stay of payment of three years, the period for such actions could reach five years or more (two years before the request, plus three years during which there would be no breach of contract if decided as a total stay of payment

and the period between then and the breach).

- Finally, in the spirit of helping entrepreneurs, the rule introduces a sort of "fresh start" opportunity in the Spanish procedural system. Under this provision, a fortuitous insolvency would conclude with the declaration of the debt remission (except for public institutional debts), provided that the credits against the estate have been paid and all privileged credits have been satisfied (also foreseen outside of the subsequent insolvency proceedings if at least 25% of the amount of the ordinary credits in the insolvency proceedings has been paid).

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