

INSOLVENCY: RESTRUCTURING OUTSIDE FORMAL PROCEEDINGS - LINKLATERS

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In March 2014, a new royal decree-law came into force in Spain introducing urgent measures concerning the refinancing and restructuring of corporate debt. The main aim of the reform is to establish a legal framework to enable operationally viable companies to restructure outside

formal insolvency proceedings.

The Spanish government has taken steps to modify the refinancing regime because experience has shown that, in the vast majority of cases, Spanish insolvency proceedings do not serve to restructure struggling companies.

The new regime introduces a host of changes to the existing Spanish insolvency Law. In particular, it (i) simplifies the rules on the existing refinancing agreements that cannot be set aside; (ii) creates a new class of refinancing agreement, which are also protected from being set aside; (iii) significantly extends the scope of the refinancing agreements that can be sanctioned; and (v) implements a number of concrete measures to make refinancings more likely to succeed, including stays on enforcement during negotiations and imposing liability on directors and members that do not act responsibly in refinancing processes.

It is difficult to say which aspects of the reform are truly the most important because it involves many major changes. However, three are particularly significant.

First, the new rules establish new effects of filing a 5 bis notice. The 5 bis is a communication that the debtor files to inform the Commercial Court of restructuring/refinancing negotiations. During the 5 bis period (being three months of negotiations and a further month to file for insolvency) the directors' duty to initiate insolvency proceedings is suspended and no creditors can initiate a compulsory insolvency. Before the reform the filing of this communication did not affect creditors' ability to enforce security. Now the reform expressly states that enforcement actions cannot be commenced and enforcement action already commenced is stayed in respect of assets that are necessary for the debtor's business. Enforcement proceedings brought by secured creditors are also stayed and individual enforcement by financial creditors is prevented or stayed, provided that it can be shown that 51 percent of financial creditors approve.

Second, another significant change – since it affects the regime of liability within insolvency proceedings – is that shareholders or directors can be found guilty of wilful misconduct or gross negligence by causing or aggravating the debtor's insolvency when, without reasonable cause, they refuse debt conversions or an issue of convertible securities or instruments, frustrating attempts to reach a refinancing agreement.

And third, the new rules involve a radical overhaul of the way in which Spanish courts sanction refinancing agreements. The new regime extends the creditors which can be crammed down. The previous regulation stipulated that only unsecured "financial institutions" could be crammed down under Spanish schemes of arrangement and only if they were not financial institutions holding *in rem* guarantees. The law now states that court approval binds all those that have a financial claim against the debtor (irrespective of whether they are a financial institution) and secured creditors if certain majorities are met.

Additionally, the new regime extends the scope of the measures that can be imposed on non-participating or dissenting creditors through Spanish schemes of arrangement. Prior to the reform, stays could only be imposed on *unsecured* non-participating or dissenting creditors. However, under the new regime, all holders of financial liabilities can be forced to accept write-downs, stays, debt-to-equity swaps or conversions of debt to participating loans.

Furthermore, courts are no longer required to assess "disproportionate sacrifice" to sanction the scheme, as was the case before. "Disproportionate sacrifice" will only be examined if it is alleged by any non-participating or dissenting creditors at the stage when objections can be lodged against the court order sanctioning the scheme.

As mentioned, the amendments introduced on refinancing agreements sanctioned by Spanish courts are very important. They imply going from court-sanctioning processes that were of virtually no use because of their serious limitations, to a system of court approval that, despite various unknowns as to its practical application, appears to be a valid tool for dealing with dissenting creditors in complex restructuring and refinancing situations.

In a nutshell, this piece of legislation represents a complete turnaround on the part of Spanish lawmakers, who unlike before, are now firmly behind resolving insolvency situations outside formal insolvency proceedings.

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