

RESTRUCURING & INSOLVENCY REPORT 2009: OVERCOMING A CRISIS OF CONFIDENCE

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“I think we will now see the AdC take a much more discreet approach in some respects. There may be less cases but there will be, I hope, a much more rigorous and efficient approach in the analysis of matters.”

Nuno Ruiz, Vieira de Almeida

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The issues being presented by clients to Iberia's restructuring and insolvency lawyers remain consistent, but as the financial crisis evolves their relative weight in the equation might have changed, say many. Significant also has been the change in attitude of market participants. From an initial state of shock or even denial, a more pragmatic approach has emerged – parties are increasingly willing to sit down and try to find solutions, while lawyers are now drawing on precedents and restructuring models that did not even exist a year ago.

At the start of the credit crunch, in 2007, it was predominantly Iberia's real estate and construction sectors with exposure that suffered the most – the market had collapsed and there was no access to finance. It was also a period in which refinancings were still the norm.

Almost three years on, lawyers report that virtually the entire Iberian economy has been affected. Restructuring and refinancings remain challenging while the number of company insolvencies has exploded. Nonetheless in many instances, creditor banks still prefer to avoid liquidation – in Spain at least because they have to make provision in their own accounts for potential losses – and are willing to extend refinancing terms, to part-forgive claims or now convert them into some sort of equity.

Debt-for-equity and asset swaps have been a feature of a number of real estate restructurings of Spanish companies considered too big to fail in recent months, notably of Metrovacesa and Colonial. However some, including publicly listed Martinsa-Fadesa, have proved incapable of rescue - the insolvency being managed by Gómez- Acebo & Pombo. Insolvencies in Portugal may still be dominated by small and medium-size companies, but the bankruptcy of German computer chip maker Qimonda earlier this year, led to the collapse of its subsidiary Qimonda Portugal and the loss of around 1,600 jobs.

The economic situation across Iberia remains fundamentally a question of confidence, believe many

lawyers.

"The boom years we have seen over the past decade will not come back for a very long time, perhaps twenty years, and a consequence of which is that companies will have to continue to adapt to the new economic reality," says Javier Castrodeza, Head of Restructuring and Insolvency with Cuatrecasas Gonçalves Pereira.

Some suggest that the ability of banks to access funds from Central Banks, lent at an artificially low level, is breeding a false sense of economic security.

Though both the Spanish and Portuguese stock markets may have rallied over the summer there remains considerable volatility and distrust of company finances.

"The lack of liquidity in the markets has been partially restored, but risk management by financial entities has become tighter. The crisis has generated an atmosphere of distrust, which forces all economic agents to be more cautious in their decisions and more willing to take legal advice beforehand," says Antonio Fernández, Head of Restructuring and Insolvency at Garrigues.

Among clients' greatest concerns are questions around the effects of insolvency on creditors' rights and the best ways to prevent any risks. "Clients search for credit guarantees that, within insolvency proceedings, may secure them payment," says Luís de Gouveia Fernandes, partner with Abreu Advogados in Lisbon.

Notable also, say some, are evident moves by the banks to cleanse their loan portfolios and balance sheets – businesses unable to demonstrate continuing viability, or to access alternative funding, will inevitably become victims.

"Nowadays, the climate is definitively better in comparison but the accrual of failing companies continues to occur pursuant to the financial difficulties still felt in the market," says Nuno Libano Monteiro, a disputes and insolvency partner at PLMJ.

"Internationally, the authorities are struggling to make state aids, derived from the crisis context, compatible with competition law principles."

Inigo Igartua, Gómez-Acebo & Pombo



All sectors

The current economic situation is far beyond anything previously experienced, say practitioners. "Today almost all sectors are facing the troubles caused by the credit crunch. So now it is not a question of which sector will suffer most but who within each industrial sector will survive the crunch and get out of it in a better shape," says Antonio J. Navarro, Head of Finance at Valenciabased Broseta, which has been involved in the bankruptcies of Martinsa-Fadesa, Grupo Llanera and Ivarte-Singer among others.

Many companies that refinanced at the start of the crisis – when the belief remained that the markets might soon recover – may also now face new refinancing difficulties over the coming months.

"Certainly sectors will continue having problems as refinancing operations come to maturity and cannot be met in the foreseen terms. Also, many industrial operations leveraged up some time ago will not be able to repay the capital, which means that they will also declare bankruptcy," says Joan

Albert Salsas of Roca Junyent.

The business plans used in many early restructuring have proved totally unrealistic, say others.

"Uncertainty is now affecting other sectors but it still persists in the construction sector and in many cases, refinancings completed 12 or 18 months ago will start being in default and, thus, companies refinanced before, will now fall into insolvency," believes Agustín Bou at Jausas.

Some suggest that of the estimated €300bn that has already been injected into the real estate and construction sector in Spain alone, 30% may require refinancing. However, any company that had grown on the basis of leverage is likely suffering because of tighter credit restrictions and it may therefore take years before the effects of the current economic crisis are absorbed.

El reportaje anual sobre Reestructuración e insolvencia expone los constantes problemas que aún se presentan a las empresas. Las situaciones de insolvencia o necesidad de reestructuración siguen siendo alarmantes, sin embargo muchos comentan que a medida que la crisis financiera evoluciona, su peso específico varía, siendo significativo el cambio de actitud de las partes. Del estado inicial de "shock" e incluso de negación, ha surgido una corriente más pragmática – las partes ahora están más abiertas a sentarse e intentar buscar soluciones. Esto permite a los abogados sentar precedentes y crear modelos que ni siquiera existían hace un año.

"We continue to see second or even third-round refinancings, as the primary aim of the parties involved continues to be the avoidance of insolvency proceedings. For the time being, a short term approach continues to prevail. As the future continues to be so uncertain, it is difficult to plan long term scenarios," says Iñigo Villoria, insolvency and restructuring partner at Clifford Chance in Madrid.

Others are even more alarmist.

"Some of our clients are telling us that the level of restructuring and insolvencies we are currently experiencing is mere training for the flood to come over the coming year," says Ignacio Ruiz-Cámara, banking and finance partner with Allen & Overy in Madrid.

Scrutiny

Lawyers note also that many of the corporate mergers that are currently being seen in the domestic markets are inevitably also the fall-out of restructuring and insolvency programmes.

"Divestment and restructuring work has seen an increase in the past months mostly due to its underlying cost-saving and downsizing intentions – massive lay-offs have been very common in Portugal this past year," says Susana Pimenta de Sousa, corporate partner with Garrigues in Lisbon.

Such strategies are though proving positive with the finance community, say others. "The banking sector is starting to ease access to investment to companies that are willing to restructure themselves and there are sectors and companies, which have been living with the economic crisis for a long time, now implementing strategies to overcome their problems," says Nuno Pena, litigation and tax partner at Rui Pena Arnaut & Associados.

Evidence of how deep the crisis runs in Spain is the emerging restructuring of much of the country's finance sector. Many savings banks (caixas in Galicia and Catalonia and cajas elsewhere) were heavily exposed to the collapse of the real estate sector and forced to make massive asset writedowns.

In March the Government was forced to rescue Caja Castilla La Mancha (CCM).

"The consolidation of the cajas is an example of the process. Through a merger it is possible to remove operational overlaps, to close branches and cleanse balance sheets," says Villoria at Clifford Chance.

Others suggest that 'mergers' are a euphemism, as there is not the political will to foreclose on the most vulnerable institutions. The issue for financial institutions and companies remains therefore how to account for their losses, say lawyers.

But even mergers are being scrutinised much more closely than was ever previously the case.

"Growth arguments in terms of revenues, cash flow or sales are not accepted to justify or calculate prices for transactions or repayment capacity. The feeling is that the crisis will last for years," says Alberto Niñez-Lagos, a restructuring and insolvency partner at Uría Menéndez in Madrid.

"Acquirers are now asking 'Is there a risk that this company can go insolvent in one or two years' time? They want to be sure of any strategic moves they make," agrees Fernández at Garrigues.

"In our view, the publication of guidelines setting out the limits of the authority's investigation powers during dawn raids would be a positive measure."

Álvaro Iza, Freshfields Bruckhaus Deringer



Involvement

Some suggest however that structural issues will continue to surface, even among companies returning to the market having sold off assets, so long as demand remains depressed. Notable has been the growing impact on the automobile, manufacturing and aviation sectors as the crisis has taken hold and consumer demand has continued to fall.

"The question is how effective have some of these restructurings been, particularly in the real estate sector. A perceived restructuring that only ends in the company still failing does not give a positive image of the benefits of the process," says Villoria at Clifford Chance.

Public confidence in the restructuring process has inevitably been affected by high profile collapses, say lawyers, including in Spain of Martinsa-Fadesa and more recently of mid-size real estate group Nozar, which in September filed for creditor protection with debts in excess of €2bn – the third-biggest failure in the sector.

Banks may be more willing to explore non-judicial remedies to avoid immediate insolvency, but the recurring issue, say lawyers, is where will the fresh money come from. Spain, along with the UK, may lag behind the recovery of many of Europe's other major economies, but is not yet seeing an influx of opportunistic acquisitions from international investors.

In addition many question the ability of the Spanish or Portuguese governments to manage either country out of recession. In Portugal significant emphasis is being placed on the positive economic impact of major infrastructure projects, while in Spain there is a perceived reluctance to reform the country's highly restrictive labour laws, while maintaining commitments to raise taxation levels.

"More effort has to be made to involve the social security and tax authorities in the restructuring process, to help ensure continuing tax receipts rather than government payouts. Otherwise the impact will be more companies in difficulties, which is of no benefit to their employees or the state," says one Madrid partner.

Viable alternatives

Fundamental to the success of restructuring schemes, and the equity of the insolvency process, is

the strength of the relevant domestic legislation. Lawyers in Spain and Portugal may retain broad confidence in their respective legislation but practical issues continue to surface, they say, in the face of the current overwhelming demand.

"Insolvency laws do not need to be changed, they need to be put into practice. The more relevant problem we face is that there are not enough qualified court or other professionals with the specific knowledge of the insolvency procedures. This causes late, inadequate, and sometimes, dramatic decisions," says Nuno Pena at Rui Pena, Arnaut & Associados.

Others suggest however, that the domestic Portuguese law does still require significant amendments, particularly because it is so creditor-focused.

"The Portuguese model does not incorporate debtor control. A debtor cannot of its own accord file for and control the restructuring process as in US Chapter 11 (and France, Italy, UK and to some extent the German restructuring model). A Portuguese debtor can apply to liquidate the company but not to reorganise it," says Claudia Santos Cruz, corporate partner with Barrocas Sarmento Neves.

The Spanish Insolvency Law, updated in March 2009, although modern and debtor-friendly nonetheless fails to sufficiently incentivise and protect pre-insolvency and out of court arrangements, and is mainly being used to liquidate companies.

"We need useful out of court restructuring tools, which we are missing, like statutory stand-still, binding majority decisions and protection against claw-back; but we also need much quicker insolvency proceedings when court restructuring is unavoidable," says Fernández at Garrigues.

"There also are very strict rules on distressed debt trading, which makes it difficult for these kinds of investors to come into deals in Spain and provide their expertise for company turnarounds," adds Jesi's Almoguera, Head of Corporate at Ashurst in Madrid.

Notable, say some, is that on the day the new law was enacted the Spanish Minister of Justice announced that further reforms were necessary. But also, that the new law, while well intended, has failed to work in practice because it is influenced too heavily by academic thinking.

"There have been attempts to change the law, but these always come too late. The push for the most recent reform of the law in Spain was the high profile collapses of companies such as Habitat and Martinsa-Fadesa, but which have failed to address the issues that led up to such a situation, and therefore do not offer a viable alternative to mere liquidation," says Castrodeza at Cuatrecasas Gonçalves Pereira.

New thinking

What is also required is a change of attitude towards the insolvency process particularly by many of the major creditor banks, say some.

"Lenders have to be able to take a much more long-term approach and be willing to inject significant sums – tens of millions – into companies to really turn them around, rather than merely prop up businesses in the hope that someone will come to the rescue," says Ruiz-Camára at Allen & Overy.

Fundamental also is to ensure the ability of the Courts to follow the spirit of the insolvency legislation and to make decisions quickly.

"The most frequently seen issues involve those surrounding the general sluggishness in judicial proceedings. In this environment, we frequently advise clients that extrajudicial solutions may be preferable, specifically conciliation proceedings coordinated by an institute organised under the Ministry of Economy. Indeed, in the current economic climate, settlements between creditors and

debtors are often made more quickly under such framework," says Tito Arantes Fontes, partner with Uría Menéndez in Lisbon.

The volume of cases courts now face, in Spain and Portugal, is having a paralysing effect.



"The regulators in Portugal are under pressure from both the media and political parties to increase their surveillance on some sectors – particularly financial, oil and gas operations."

Ricardo Oliveira, PLMJ

"We have to live with the Commercial Courts that we have – they have more work than they can handle efficiently and collaboration with Courts and administrators in order to find priorities is the only way of overcoming the difficulties," believes José María í lvarez Arjona of Gómez-Acebo & Pombo in Madrid.

The creation of dedicated Commercial Courts handling bankruptcy issues is widely applauded, but they have seen their workflow grow exponentially, while staff numbers have remained largely unchanged. Proceedings can therefore take much longer than set out by the relevant legislation.

"In order to preserve clients' interests under these circumstances, we recommend them to appear in or begin the corresponding proceedings as soon as possible.

Notwithstanding this, the last reform of the Bankruptcy legislation has helped promote out of court restructuring and thus limited the courts' overload to some extent," says Félix J Montero, Co-Head of Arbitration at Pérez-Llorca.

From January until September 2009, Portuguese Commercial Courts however registered a 40% increase in declarations of insolvency by comparison to the same period of the previous year, note lawyers there.

"We now spend much of our time travelling the country to different client hearings," says Miguel Esperança Pina, disputes partner with Cuatrecasas Gonçalves Pereira in Lisbon The same volume of issues, and delays, are inevitably also being seen in employment tribunals, says fellow partner Maria da Glória Leitão, with a dramatic increase also in collective bargaining. "It can take as long as 12 months to get a final judicial decision, which is clearly not a viable proposition for companies facing immediate difficulties."

Reaching any agreement, even outside of court, remains complicated requiring the balancing of the interests of Insolvency Administrators, the Creditors Commission, the Creditors Assembly and the insolvent entity itself.

Delays, regardless of where they occur, can be devastating on an otherwise recoverable business.

"Our advice to clients is to try to anticipate and make progress on any work that can be taken off the court's hands, as soon as possible – educating the insolvency administrators on the business and where problems arise, and carrying out conversations and negotiations with creditors early on," says Almoguera at Ashurst.

Lessons learnt

Clearly lessons have been learnt by practitioners since the onset of the credit crunch. And while there will be winners from the crisis, many entities are simply looking to survive, say lawyers.

"Many of the early refinancings saw banks adopting short-term solutions for distressed companies, some how denying the real problems," says Ruiz-Camara at Allen & Overy.

What is required, believe some, is more flexibility in the pre-insolvency stage. Provisions may now exist in the domestic legislation to enable creditors and debtors to explore options, but there is no clear USstyle Chapter 11 bankruptcy protection for companies in financial difficulties.

"The reality is that much of the work we currently do is an attempt to avoid formal bankruptcy proceedings but often there is no alternative. Without the necessary preferred creditor protections, new finance is simply not available, even to seemingly viable businesses," says Castrodeza at Cuatrecasas Gonçalves Pereira.

Experience shows that the value of the business entering the formal insolvency process may be destroyed or substantially damaged, and that incentives are required to encourage creditors to restructure out-of-court and to avoid insolvency, say lawyers.



"I am a firm believer in the US style workout system, but to work in Spain this would require a very significant change in mentality. We see US situations involving Spanish assets and there is a totally different mindset involved. It is a very non-judicial process," adds Ruiz-Cámara.

A fundamental issue inevitably is the preference given to creditors in the insolvency process.

"The main concerns of clients who face such situations are usually: how to maintain the business value, and to minimise liability risk. There is, in our view, a priority to safeguard the value of the asset while trying to ease the burdens that weigh on entrepreneurial activity," says Antoni Frigola, Ex-Magistrate and now Of Counsel with DLA Piper in Madrid.

Lawyers highlight a need for new money granted as part of the restructuring to be offered a privileged position in the event of a subsequent insolvency, in order to encourage the workout process.

Insolvency proceedings may be the ultimate escape from the creditors, but companies can preemptively take matters into their own hands.

"At the end of the day, 99% of clients would prefer to find a solution outside of the Court system, but it is ultimately their decision to formalise proceedings.

We can look to help clients but only if they ask for help," says Borja Garcia-Alaman at Garrigues.

Magdaleno Carmona, insolvency partner at Broseta in Spain, agrees: "Unfortunately, the great problem that faces bankruptcy administration is that the process is not seen as a useful tool to overcome the crisis, but rather the contrary. Employers try to avoid insolvency proceedings until the situation is untenable – it is then too late to try as a bankruptcy administrator to help the company."

Good news

Despite an evident sense of despondency among many practitioners in the restructuring and insolvency arena there is however still some good news. A few sectors remain less affected by the structural issues affecting so much else of the economy – notably the energy and renewable sectors – while the crises at home have helped push leading Iberian banks, infrastructure operators and telecoms companies to search out new international markets.

Following the recent general elections in Portugal, market players also now have a better sense of the political and economic trend, say some in Lisbon, and may be prepared to resurrect operations suspended from the start of the year.

"The wealthiest players are in a condition to be more aggressive in their acquisition strategy in the current distressed scenario. Simultaneously, companies who were able to survive this 'enforced standstill' in view of the passivity of their creditors, will now have to face increased difficulties in dealing with competitors who will try to take this opportunity to expand their market share," says Nuno Ferreira Lousa at Linklaters in Lisbon.

In Spain, there is also an emerging momentum for further reform of restructuring and insolvency regulation, with a Ministerial Commission created to study the need for further developments. Lawyers though admit that it is often difficult to lobby directly for significant reform, as they must balance the competing interest of their creditor finance and debtor corporate clients.

"There is much whispering as to the remedies required but it is difficult to be too open about such issues," says one prominent Madrid partner.



The major banks particularly wield enormous power, as they are often by far the largest body of creditors in most domestic insolvency situations.

"But both sides of the table increasingly see that they are consistently facing the same issues or at least very connected issues and there is a growing willingness to find common solutions to problems," says Castrodeza at Cuatrecasas Gonçalves Pereira.

The recurring challenge is however to convince creditors not to seize their money too early and risk the total collapse of a debtor company. "We need to demonstrate concrete examples that a more flexible approach can benefit both creditors and debtors, but currently they remain few and far between," says Villoria at Clifford Chance.

The trend towards debt-for-equity swaps may have aligned the interests of some creditors and debtors, but many institutions remain reluctant to take on any additional liabilities that may impact negatively on their own profit and loss accounts.

Complex challenges

While even the most experienced lawyers continue to be shocked by the scale of the issues their teams now face on a daily basis, there is no doubting the professional rewards involved. And in many respects law firms are suffering the same challenges as their clients, restructuring and

insolvency remains a hugely important area of practice but one which faces tremendous fee pressures.

"We would all prefer the economy to be in a much healthier shape, and we may not get the medals our M&A colleagues receive when they complete a major transaction, but there is no doubting the satisfaction in being able to lead a client through the desert and bring them back from the brink of insolvency," says Fernández at Garrigues.

Complex challenges will continue for the near future and even with a consistent period of market confidence any recovery will likely be 'www-shaped' rather than merely 'w-shaped', believe many.

"There is no doubting that in Spain at least, there is more than a real estate crisis. The effects are felt in virtually all economic sectors. It is difficult to predict with certainty, but it may take some time to get out of this situation. After a big party, inevitably comes a big hangover," concludes Carlos de Cárdenas, a finance partner at Uría Menéndez.