A SPANISH SECURITY LAW APPROACH FOR U.K. (AND OTHER FOREIGN) LENDERS – PRACTICAL ASPECTS OF STRUCTURING, NEGOTIATING AND CLOSING THE DEAL

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Miguel Lamo de Espinosa Abarca
LL.M. in Securities and Financial Regulation, Georgetown University
Admitted to practice in Spain and New York
Resident Partner of the London Office of Gómez-Acebo & Pombo Abogados, S.L.P.
Banking and Capital Markets Department

Alejandro Alemany
Admitted to practice in Spain and England & Wales
Associate of the London Office of Gómez-Acebo & Pombo Abogados, S.L.P.
Corporate Department
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1. INTRODUCTION

The purpose of this article is to assist foreign lenders (and their counsel) in the process of considering, negotiating and perfecting security interest in Spain (i.e. security over assets located in Spain and over which, according to Spanish Law, a Spanish Law security may be created). After some experience advising foreign lenders in configuring their security interest in Spain we have noticed that: (i) some concepts and formalities under Spanish (and mainly continental) law are not correctly understood and (ii) the issues that appear as problematic in all transactions in which we have been involved are in broad terms the same, or result from the application or interpretation of the same principles.

As the reader may be aware of, the Spanish territory is divided into regions or Autonomous Communities (“Comunidades Autónomas”) which have the authority to rule and to enact regional laws, and where appropriate, to set the tone for their interpretation. Some of these regional jurisdictions may impose further/different requirements for granting securities, than those set forth in Spanish Law. We will herein focus only in the main dispositions of the Spanish Civil Code and dispositions applicable to the majority of Autonomous Communities, which we trust should be sufficient guidance for a foreign institution to have a picture of these securities and their mainstream regulations. However, upon granting securities in Spain local counsel is paramount to avoid issues with regional or local laws that may also apply.

The reason for focusing this article to U.K. lenders and counsel results directly from the experience of the authors and the questions faced when dealing with a high number of matters from the London Office of Gómez-Acebo & Pombo. Having this been said, there is no reason why this article may not be used or applied also by any foreign lender or legal counsel.

The article is mainly divided into two different Sections, a first Section (Section 2) aimed at describing the main characteristics of the more commonly used Spanish security and a second Section (Section 3) aimed at describing and analysing the frequent problems regarding Spanish Security and their alternatives. This latter Section is also divided into four Sections which differentiate the point in time in which the analysis is made: (i) the initial stage of configuring the Security, (ii) the secondary stage of drafting, closing and perfecting the security, (iii) a third stage elapsing from perfection to termination of the secured obligations (or full repayment of the secured facility) and, (iv) the analysis of a default, breach, enforcement or insolvency scenario.

For the sake of clarity, for the purposes of this article the following terms will be defined as follows: “Security” means a security interest created or to be created over a particular asset; “Secured Obligation” means the payment obligation which is secured by a particular Security, this being the repayment of a previously granted facility or a newly granted facility, “Secured Party” means the party (or parties) which is benefited from the Security and which would have the right to enforce the Secured Obligation; “Debtor” means the party who has the obligation to pay the Secured Obligation to the Secured Party, it being the “Grantor” or not; “Grantor” means the party granting the Security, either securing its own obligation (in which case Grantor and Debtor should be the same party) or securing the obligation of a third party (in which case Grantor and Debtor are different entities); “Civil Code” means the Spanish Civil Code; “Insolvency Act” means Law 22/2003 regarding insolvency (as amended from time to time). Finally, terms such as “entities” or parties should be understood as including any party with legal capacity (either a person or a corporation).

2. MORE COMMONLY USED SECURITY: MAIN CHARACTERISTICS

There are mainly two types of rights in rem which are used generally in Spain, pledges and mortgages. These are not the only ones that may be used, but are indeed the most commonly used. In addition, it is convenient to briefly describe the so called
“promissory security” or “promesas de constitución de garantías”, due to the fact that there are many matters of confusion for foreign lenders regarding these commitments.

2.1. Pledges

Pledges in Spain are mainly divided into two types: (i) possessory pledge (the “Possessory Pledge”), in which the possession of the pledged asset is delivered to the Secured Party and (ii) non-possessory pledge (the “Non-Possessory Pledge”) in which possession of the asset remains with the Grantor. Non-Possessory Security is regulated by Act dated 16 December 1954 together with the mortgage over chattels or movable goods (the "Chattel Mortgage") and is limited to certain assets such as agricultural fruits, animals, art pieces, machinery, inventory and intellectual property. The Possesory Pledge may however be used to pledge other assets (including those mentioned above) provided that a transfer in the possession of the pledges asset is effected.

Given the preference which market practice has given to Possesory Pledges over Non-Possessory Pledges we will in this article exclusively focus on the former, leaving the latter for a further study. The main Possesory Pledges used in current Spanish deals are pledges over shares/units representing the equity of a corporation, pledges over receivables and pledges over credit rights resulting from bank accounts or deposits (which are nonetheless receivables but which have certain particularities).

(a) Pledge over shares/units

Under Spanish Law there are mainly two main types of limited liability corporations, the “Sociedad Anónima” or “S.A.” and the “Sociedad Limitada” or “S.L.”. Regardless of their multiple distinctions, which are not pertinent for this analysis, both “Shares” (or “Acciones”) for an S.A. and “Units” or “Participaciones Sociales” for an S.L. represent a participation in a corporation which grant their holder certain established rights, mainly political (voting and right to appoint its representatives) and economic (payment of dividends). The Shares may also for the purposes of this analysis be divided between shares listed or admitted to trading in a market (for which a registration statement has been filed and is in effect) and Shares which are not listed or admitted to trading.

Taking security interest in Shares and Units is commonly used and accepted in Spain and provides with no real interpretation concerns. The Grantor (which must be the registered owner of the Share/Unit) grants a public deed of pledge, notes the interest of the Secured Party in a particular Share certificate and delivers the same to the Secured Party (only in the case of S.A.s) and notes the existence of the pledge in the Shareholder’s Registry Book. Without prejudice to the issues and concerns which will be pointed out later on, this security may be considered as a fairly reliable and easy Security to obtain, although in certain circumstances (specially when the security is granted over the shares/units representing the equity of the Debtor) its real value on an insolvency or default scenario may be very limited.

When the pledge is to be granted over Shares of a listed company the procedure is very much similar but the noting of the pledge in the Share certificate and in the Shareholder’s Registry Book is substituted by notice to the entity in charge of the book-entry registry for that particular company and the issuance by the latter of a certificate evidencing the existence of the pledge.

A question arises however with regards to the pledges of shares/units issued by a foreign corporation but located, deposited or registered in Spain. Article 10 of the Spanish Civil Code establishes that the law applicable to rights in rem over movable goods (such as Shares/Units) shall be the law applicable to the place where the movable good is located; thus Spain in our case. However, although technically correct,
the foreclosure of the pledge must be deeply analysed, since although it will follow Spanish proceedings, the formalities and requirements of the law of the issuer will be relevant for the purposes of selling the shares in a public auction and ensuring due transfer under issuer’s applicable law.

(b) Pledge over receivables

Pledges over receivables are also fairly standard in Spanish practice. Although there is no relevant regulation (save that provided for in Section 90.6 of the Insolvency Act and the act 5/2005) they have been accepted by scholars and are customary practice in Spanish deals. The pledge of a credit right (i.e. a right of the Grantor versus a debtor to receive an amount of money, a “Receivable”) may be pledged by granting the required public deed of pledge and the required transfer of possession is obtained by giving notice to the debtor of the Receivable of the existence of the pledge.

The complexity arises when establishing the degree of determination of the Receivable required when granting the Security. For example, can a future Receivable be pledged? can a Receivable with a yet unknown debtor be pledged? This issues will be dealt with in Section 3 below.

(c) Pledge over Bank Accounts

Pledges over the credit rights of a Grantor vis-à-vis a Bank resulting from a bank account or deposit are also generally pledged in Spanish deals following the same pattern and procedure that pledges over regular Receivables (i.e. granting the public deed of pledge and giving notice to the debtor, in this case the bank that holds the account or deposit). The granting and perfection of this pledge is fairly simple and the concerns usually result from determining the role of the depositary bank and their duty to block the pledged account. These issues will also be dealt with the Section 3 below.

2.2. Mortgages

Again there are two main types of Mortgages under Spanish Law: (i) mortgage over real estate or immovable assets (the “Mortgages”) and (ii) mortgages over chattels or movable assets (the “Chattel Mortgage”). Chattel Mortgages are regulated by an act dated 16 December 1954 together with the Non-Possessory Pledges and are limited to certain assets such as machinery and intellectual property. Although also commonly used in Spanish deals, we will herein only analyse the Mortgages leaving the Chattel Mortgages to a further study.

The Mortgage is a security which is granted over real estate and which “runs with the land”. Mortgages are extremely common in Spanish deals and would presumably be more common absent the cost associated with them which is described in Section 3 below. In order to create a Mortgage the Grantor (the real estate titleholder) will appear before a Notary public in order to grant a public deed of mortgage and will have such public deed registered with the Land Registry. The deed of Mortgage shall contain a vast deal of formalities among which one concerns the most: the maximum secured amount.

Spanish law requires that a Mortgage includes a maximum secured amount which is the maximum amount for which the asset is charged. This is, any amount obtained beyond such amount by the Grantor upon a foreclosure shall belong to the Grantor (or other subsequent secured creditors), and not to the Secured Party. The law also provides certain limits to establish the maximum secured amount (as regards recovery for interests, delay interests and costs) and the taxes to be paid due to the Mortgage will be calculated on the basis of this amount. This is why this amount becomes so relevant (see Section 3 below).
(a) Special mention to Floating Mortgages

The Spanish Act 41/2007, amended the Mortgages Act and for the first time set forth the rules of Floating Mortgages ("FM"). FMs are governed by Section 153 bis of the Mortgages Act.

FMs are Mortgages whose particularity is that the Mortgage floats between all the Secured Obligations, without making any distinctions amongst them (i.e. the maximum secured amount secures more than a single obligation). Although it is generally a matter of confusion note that FMs are floating on the side of the liabilities, but not on the side of the second asset (as would a foreign floating charge).

The particularities of FMs are the following: (i) a FM is a security securing one or more credits; (ii) the secured credit(s) may or may not be existing at the time of granting the security (i.e. when the deed of mortgage is executed); (iii) the security does not establish a division of the maximum secured amount between the Secured Obligation(s); (iv) the Secured Obligations do not need to arise from the same legal relationship; and (v) a creditor may enforce an FM upon breach of any of the Secured Obligations.

This nevertheless, the Secured Obligations need not to be in existence when the FM is granted and need not be specified in the deed of mortgage. The deed of mortgage should only specify the basic acts from where the Secured Obligations arise or may arise in the future.

FMs may be used to secure: (i) several obligations with a maximum overall amount of responsibility; (ii) several obligations that are independent from each other (i.e. that do not arise from the same acts or obligations); (iii) present or future obligations; (iv) obligations with determinate or indeterminate amount; and (v) tax and social security credits.

As with any mortgage, a FM shall be created by means of a public deed, which shall set forth:

- The legal act(s) or contract(s) from which the Secured Obligation(s) arise(s). If such legal act(s) or contract(s) are/is not yet in force, the name of such act(s) or contract(s) or a description should suffice;

- The maximum secured amount;

- The term of duration of the Mortgage; and

- The calculation formula of the cancellation amount.

2.3. The use of promissory security

There are many wrong understandings over what under Spanish Law is known as Promissory Security or “Promesa de Prenda/Hipoteca”, this being the reason why it is convenient to make a brief reference to this legal construction. Promissory security is not a Security, but only a promise or commitment to grant a Security over a particular asset (i.e. until the promise or commitment is complied with there is no perfection of a Security and the asset may be considered as being free of liens or encumbrances) within a certain period of time. The commitment may be required to be accomplished at any time the parties agree, such as at a particular date, when certain circumstances concur or when notice by the Secured Party is given. However: (i) until the Security is granted and perfected over the promised asset there is no preferential right over the same for the Secured Party in an insolvency scenario or otherwise and (ii) until the Security is granted and perfected the Security right does not attach to the asset and

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1 Decree of 8 February 1946, approving the Mortgages Act. as amended
therefore the right “does not run with the asset”. If the promised asset is sold or disposed by the Grantor to a third party, such sale will most likely be a breach of the promissory commitment and may entitle actions by the Secured Party against the breaching Grantor, but it will not grant the Secured Party a right to claim against the asset (now owned by the third party). Also, as will be studied later, the promissory security may be put at risk if the Security is to be granted after an insolvency scenario or on the two years preceding the same.

Therefore, although the promissory security may be an interesting commitment to obtain and will create a valid and enforceable obligation of the Grantor for the benefit of the Secured Party, such obligation does not attach any right to the asset and the breach of the same or of the Secured Obligation may not be enforced against the asset with priority over other creditors unless the promise has been fulfilled and the Security has been perfected.

3. FREQUENT PROBLEMS REGARDING SPANISH SECURITY AND ALTERNATIVES

This Section does not purport to be comprehensive, but only a useful guide before creating Security in Spain. The issues dealt with below represent a list of usual concerns of lenders organised on a time basis, from configuring the Security to pay-off of the Secured Obligation or initiation of an insolvency scenario.

3.1. Configuring the Security

(a) Costs of the Security

In addition to any costs of local legal counsel for the drafting and negotiating of the documents (including translations thereof, if required - see 3.2(d) below) there are primarily three types of costs which must be analysed when configuring the security: (i) notarial costs, (ii) stamp duty taxes and (iii) registration costs.

Notarial costs will be incurred as long as the documents are to be granted in a public document, and will vary depending on the amount of the Secured Obligation(s) and may, subject to certain limitations, be negotiated with the Notary Public which will notarize the deal. It is therefore generally advisable to request estimates to a variety of Notary Publics before opting for one or another.

As regards taxes there is one principle to be followed when preliminary analysing the costs of a security: if the security is to be granted in a public document and should have access to a public registry, taxes will most likely accrue. Therefore, in general terms Possessory Pledges will not accrue any tax whereas the granting of Mortgages will imply the payment of Stamp Duty. The amount of the tax will depend on the maximum secured amount and is generally calculated by applying a rate (which currently varies from 0,5% to 2,00%, depending on the place where the asset is located). For the purposes of calculating the Stamp Duty, the taxable base (i.e. the maximum secured amount) shall include any amounts calculated in the deed of security in respect of interests (ordinary and default), and costs and expenses (to cover any litigation costs arisen from the enforcement). In order to register the Mortgage evidence of the payment of the tax is required. The possibility of granting a Mortgage with a low maximum secured amount which will increase upon the occurrence of a certain condition (such as a breach of covenant) has been used in the past but is no longer advisable due to recent Tax Administration rulings. There is the possibility of granting a Mortgage with a low maximum secured amount and having the Grantor promising that upon the occurrence of certain conditions it will increase such amount, although the security will not be perfected as regards the increased amount until the increase is granted before a Notary, taxes regarding such increase are satisfied, and
everything altogether is duly registered (see 2.3 above as regards promissory security). The “promise to increase” the maximum secured amount is generally accompanied by an irrevocable power of attorney granted in favour of the Secured Party so that it may execute the deed of increase on behalf of the Grantor. Such power of attorney is subject to the qualifications mentioned in (3.1.(m)) below and, moreover, the Secured Party will presumably be paying the tax before registration (unless the Grantor is willing to assume the tax, which is unlikely if it is refusing to grant the increase in the maximum secured amount).

Registration costs are charged by the relevant registry and depend on each particular registry. Local counsel should be consulted in order to determine the cost applicable to each particular case.

(b) Pledge over shares: who gets what?

Under Section 132 of the Spanish Companies Act (Legislative Royal Decree 1/2010, dated 2 July) (the “Companies Act”) applicable both to S.A.s and S.L.s, unless otherwise provided in the by-laws of the company, in case of pledge over Shares or Units the rights inherent to the same belonging to the holder of such Shares or Units shall correspond to the Grantor and not to the Secured Party. This is, unless expressly provided in the By-laws, the voting rights as well as the right to receive dividends remain with the Grantor (although subject to the Pledge) and are not transferred to the Secured Party. Upon foreclosure of the Pledge the rights inherent to such shares or units will be transferred together with the shares/units in the public auction (or alternative proceeding of foreclosure). Accordingly, even if a default of the Secured Obligation occurs, until the foreclosure is realised the rights remain with the Grantor.

In order to circumvent the above it is becoming usual to request the Grantor to register an amendment of the By-Laws simultaneously with the granting of the Pledge so that the same provide that, upon receipt by the Company of a notice of breach of the Secured Obligation, the rights will thereafter belong to the Secured Party and not to the Grantor. Although generally admitted, this amendment may be difficult to register in some Company Registries and local advice should be obtained.

(c) Pledge over Receivables: future rights or revolving security? Notice to debtors

Questions arise as regards the possibility of pledging future receivables, meaning receivables arising after the granting of the Pledge. Although the position is not a clear-cut issue, it is generally accepted that pledges over future receivables are valid and enforceable to the extent the future credit right is sufficiently identified by, for example, identifying the debtor or the activity pursuant to which the credit right is created.

Also note that it is becoming increasingly usual to have the notice to the debtor (perfecting the Possessory Security) included in invoices in situations where either the amount of contracts to be pledged are extremely broad or there is a reasonable fear that giving separate notice of the existence of the Pledge may create an impression in the debtor that the Grantor wishes to avoid. In this scenario it is mostly arguable that the pledge perfects upon receipt of the invoices by the debtors (this having consequences upon an insolvency scenario, as described in Section 3.4(j) below).

(d) Pledge over Bank Account: be careful with the notice

There is a general misunderstanding by banks receiving notice of a Pledge of one of their bank accounts that such pledge implies the obligation by the bank of blocking
the accounts not allowing any further disposals by the Grantor. Although we consider it to be a mistaken impression, it is extremely convenient to clearly include in the notice a reference to the fact that the creation of the pledge does not imply the blocking of the account unless and until a default communication is received by the bank from the Secured Party.

(e) What to do with the junior lenders: second ranking security?

Second and subsequent ranking security are expressly envisaged in the law as regards Mortgages but there is a reasonable amount of controversy as to its validity regarding Possessory Pledges. The co-existence of a number of mortgages or rights in rem over the same asset will establish a ranking among them, in accordance with the date of their registration ("prior tempore potior iure"). Granting of a second (or subsequent) ranking Mortgage will follow the same procedure mentioned in 2.2 above for the first ranking Mortgage and, in general terms, foreclosure of the second ranking Mortgage implies that the asset is sold charged with the first ranking Mortgage and enforcement of the first ranking Mortgage cancels the second ranking Mortgage.

In order to procure second ranking Security to mezzanine or junior lenders it is usual to grant the so called pledges over surplus, which charge the amounts to which the Grantor will be entitled after enforcing the first ranking security (note that not all assets being foreclosed will have a surplus so this needs to be analysed on a case by case basis). This surplus security is configured as a Pledge over future receivable and, therefore, requires perfection by transferring the possession. It is not a clear cut issue to whom the notice shall be served on in order to transfer possession, although it is generally advisable to serve notice on the Grantor and future notice on the court or agent where enforcement of the first ranking security is being effected. This nevertheless, and although it falls beyond the scope of this article to analyse the different applicable laws of each of the Spanish Autonomous Communities, it is important to notice that Lenders may encounter restrictions to create second and ulterior pledges over the same assets in some of the Autonomous Communities, as it is expressly prohibited to grant more than a single pledge over the same asset.

(f) Agreements and changes in the mortgage ranking

The mortgage ranking may be altered by agreement between Secured Creditors who may want to either postpone the ranking of a security, swap the rankings of two securities or to set forth the equivalence of ranking of all the registered rights over the same asset.

These ranking alterations are generally very straightforward and usually only require: (i) the execution of a public deed in which the aforesaid agreements, jointly with any relevant consents that may be required (i.e. from better-ranked Secured Creditors) are recorded; (ii) the payment of Stamp Duty; and (iii) the registration of the deed with the relevant Land Registry.

(j) Multiple mortgages sharing the same ranking

Special attention needs to be put on multiple mortgages sharing the same ranking in the Land Registry. This may be a suitable solution, for instance, in cases whereby multiple creditors jointly share the ownership of a credit, thus being very frequent in loan syndications.

There are two possibilities to grant mortgages with the same ranking: (i) simultaneous granting of all the mortgages; or (ii) granting of a mortgage with the same ranking than a pre-existing mortgage.
Simultaneous granting of mortgages sharing the same ranking

To grant various mortgages with the same ranking in favour of one or several Secured Creditors, the following requirements/steps should be carried out: (a) execution of the mortgages in a public deed (one or several deeds); (b) existence in the deed(s) of the agreement of sharing of rankings expressed by all creditors involved; and (c) the deed(s) need to be simultaneously filed with the Land Registry.

Granting of a mortgage with the same ranking than a pre-existing mortgage

Although admitted by the mortgage regulations, we would not advise to execute an agreement to share the ranking of several mortgages once one or more of them have already been filed with the Land Registry, as this option would require payment of additional taxes which may end up being very expensive as the taxable base of the Stamp Duty may be high (see point 3.1.(k) below). For this to be possible, (a) the creditor in favour of which the pre-existing mortgage has been granted shall express its consent to share the ranking in a public deed; (b) any Secured Creditors with intermediate-ranked securities, if any, shall also express and record their consent in a public deed; and (c) all the foregoing consents shall be filed with the Land Registry.

In any of the events under (i) and (ii) above certain intercreditor arrangements will need to be put in place to avoid one mortgage being preferential by reason of its early foreclosure.

Ranking alterations and Stamp Duty Tax. Double taxation

If one or more of the mortgages is/are already registered with the Land Registry payment of Stamp Duty Tax will be expensive, as double taxation of the Mortgage(s) that is/are registered may be incurred. Although this is a grey area, as not all Regional Courts of Justice are applying the same criteria, the Tax Authorities have recently set forth the following criteria on Stamp Duty taxation of ranking alterations:

In the case of alterations of the ranking of a pre-existing mortgage, the taxable base of the alteration shall be the maximum amount guaranteed by the mortgage whose ranking becomes inferior, as a result of the alteration.

In the case of mortgages granted with the same ranking than a pre-existing mortgage, the taxable base is the maximum amount guaranteed by the pre-existing mortgage (which had already incurred in Stamp Duty Tax).

Therefore, the benefits and cost-effectiveness of ranking alterations have to be carefully studied, and Spanish tax counsel should be sought.

Fidutia? What’s that?

In order to by-pass the difficulties that the notification of a pledge on the receivables poses, it is usual to analyse alternatives such as granting a full transfer of the receivables to the Secured Party with a right to be repurchased if no breach of the Secured Obligation occurs.

Although at first sight it seems that the legal nature of the structure proposed is that of a simple full transfer of the receivables, based on the most recent Spanish case law its nature is somehow more complicated, being that of a Fiducia Cum Creditore.

Basically, a Fiducia Cum Creditore concept provides that although formally the parties enter into a transfer (or full assignment) agreement, the real intention of the parties is not to transfer the credits (in this case receivables), but rather to transfer
those credits as a guarantee measure, thus once the Secured Obligation has been duly fulfilled by the transferor, the transferee undoubtedly will re-assign those credits back to the transferor.

Unfortunately, the effects of a *Fiducia Cum Creditore* structure are not crystal clear. There have been many theories and discussions between the scholars about the different effects that a *Fiducia Cum Creditore* has over the different participants. However, Courts do consider that despite the particular wording of the transfer agreement (as a full assignment), the intention of the parties was to have a security and the rules of a security shall therefore apply.

Consequently, if there has been no full assignment but a *right in rem* over the assets, all the requirements for constituting a Pledge must be observed - hence we once again have to face the problem of delivering notice.

**(m) Irrevocable Powers of Attorney**

It is usually recommended to have the Grantor provide with irrevocable powers of attorney to the Secured Party in order to ensure that, for example, a promissory security is granted. Although advisable, note that (i) such powers of attorney shall be notarized (preferably in the form of a public deed) and (ii) in Spain powers or authorizations, regardless of whether they are irrevocable or not, granted to a party are essentially revocable, although some case-law has accepted the irrevocability of the powers in certain events, especially where they have a purpose of guarantee. Similarly, the aforesaid powers may cease at the time the principal becomes involved in insolvency proceedings, or exercise thereof may require the consent of the court-appointed administrators in such event. Finally any bank needs to consider if by using the powers of attorney it will be prejudiced in an insolvency scenario due to being considered as a “de facto” administrator.

**3.2. Initial Formalities: from “first draft” to perfection**

**(a) The Powers of Attorney**

Pursuant to article 1280 of the CC, any power authorising the signature of a public document (i.e. notarised document) shall be notarised. This means that the act pursuant to which a person or entity (a “POA Grantor”) grants powers to a person (the “Attorney”) in order for the latter to enter into a notarised contract must be itself notarised. When the POA Grantor is a foreign corporation, the POA Grantor should notarise the power of attorney, have it apostilled (to the extent the Grantor is domiciled in a country signatory of the Hague Convention) or legalised through the High Commission and thereafter be translated into Spanish.

Spanish Notaries and Registrars require that the foreign notarisation states three fundamental facts: (i) the name of the person appearing before the foreign Notary representing the POA Grantor, (ii) that such person can validly bind the POA Grantor for the purposes of granting the power of attorney, and (iii) that the POA Grantor is a company validly incorporated under the laws of its jurisdiction. The problem always arises with (ii) above, since many foreign Notary Publics (such as some U.S. Notaries) are generally reluctant to asses as to the capacity of the representatives of a POA Grantor.

**(b) Public Notary intervention: what for?**

As a general principle, a public document grants to the parties a more expedient procedure upon judicial enforcement. This is, if the Secured Party attempts to obtain judicial foreclosure of, to say, amounts due under a facility agreement, the procedure is less burdensome if the facility was itself notarised. The reason is mainly that the
intervention of a Notary releases the claimant of certain evidence obligations. Also, note that certain security documents need the form of a notarised document for their validity, including those which, as analysed before, have access to public registries. Notarisation also grants certain additional benefits, such as the so called “liquidity agreement” mentioned in Section 3.2.(f) below.

Can a foreign law document be notarised in Spain? The answer is yes, it can, although its efficacy within a Court procedure will be diminished since proof of foreign law will need to be accomplished. However, if the Debtor and/or its assets are in Spain it is recommendable to have the credit facility and other ancillary documents notarised in Spain.

(c) Registration

The principle in Spain is that facilities (loans, credits or similar documents) and Possessory Pledges need not be registered whereas Mortgages and Non-Possessory Pledges require registration in the Land Registry for them to be effective. The procedure should be straightforward: notarising the document, paying the stamp duty and filing the document with the relevant Registry. However, note that Registrars tend to carry out a “second review” of the documents filed in matters such as compliance of the document with applicable law and sufficiency of the powers of attorney and it is not rare to see a Registrar refusing to register a document filed to him with all blessings of the Notary. Upon denial of registration due to lack of formalities the Registrar will generally grant a cure period in which priority of the document is maintained (this is, if during the cure period a different document is filed to the Registry it will, to the extent the first document is duly cured, be of second priority). Depending on the place of registration and the complexity of the documents to be registered, it might be advisable to suggest a “pre-closing” meeting with the Registrar to ensure that no formal problems will arise.

(d) Language to be used

As a general principle, if a document needs to be registered in a Public Registry it has to be drafted in Spanish. If it has no access to registries it may be drafted in any language. However, there are two additional considerations: (i) if the document is notarised the Notary Public needs to know the language and (ii) upon enforcement in Spain of a document entered into in a foreign language, the Courts may require sworn translations of the same. It is fairly common in Spain to notarise the documents which have no access to registry in English or other commonly used foreign language.

(e) The issue of perfection: how? When?

Perfection of security under Spanish law is generally accomplished by: (i) registering those guarantees which require registration or (ii) transferring possession of a pledged asset to the creditor. As mentioned above, in case of security over receivables or credit rights, the transfer of possession is said to be effected when notice of the pledged receivable is received by its debtor.

Can I perfect only upon breach by the Debtor of the Secured Obligation? The answer is in principle positive. However, note that if one takes the position that it is the notice that perfects the Security: (i) priority of the security over the asset is lost until perfection and (ii) a late notice will extend the period during which the same may be set-aside in an insolvency scenario (see 3.4 (i) below).

(f) Additional drafting on the Facility Agreement?

If Spanish security is granted securing a debt subject to a foreign law (e.g. a facility agreement governed by the Laws of England & Wales or the State of New York) it is
very much recommendable that local Spanish counsel reviews and complements the foreign law contract. The reason is that there are certain provisions which, if included in the facility itself, may make it easier to enforce in Spain. An example of this is the so-called “liquidity agreement” which means that, with an aim to benefit from an expedient enforcement procedure (absent insolvency) as well as to contribute to an immediate determination of any amounts due in case foreclosure is sought in Spain, the facility shall establish that for the purposes of articles 572.2 and 573 of the Spanish Civil Procedure Act any sum owed at any time by the debtor to the creditor shall be that specified in a certificate issued by the creditor reflecting the obligations due to it under the contract. Such sum shall be in such case be deemed net, due and payable. The “liquidity agreement” requires notarisation of the document in which the same is included, being the same that creates the Secured Obligation.

3.3. From closing to pay off

(a) Can the debt be traded? Possible use of Parallel Debt

A very common problem arises when trading foreign law debt secured with Spanish Security: the need to update the creditor’s position in the granted Security. The problem becomes greater when the security is registered, since the update of the change in the creditor position must be filed with the registry. Possible approaches to the problem: (i) the trading will not be updated as regards the Spanish Security unless a breach of the Secured Obligation has occurred, in which case all the trading will need to be reflected, notarised and, if applicable, registered, (ii) the Agent or Security Agent is empowered to execute any documents reflecting such update and to file the documents to any applicable registry and does it every time debt is traded or every certain period of time, or (iii) the use of parallel debt.

The use of parallel debt requires the inclusion of the following provisions: (i) the Debtor irrevocably and unconditionally undertakes to pay to the Security Agent, as creditor in its own right and not as representative of the other Secured Parties, sums equal to and in the currency of each amount payable by such Debtor to each of the Secured Parties as and when that amount falls due for payment under the relevant finance document (the “Parallel Obligation”), (ii) the Security Agent shall have its own independent right to demand payment of the amounts payable by the Debtor under the Parallel Obligation, and (iii) any amount due and payable by a Debtor to the Security Agent under the Parallel Obligation shall be reduced to the extent that the Secured Party has received payment in full of the corresponding amount under the general provisions of the credit agreement and any amount due and payable by a Debtor to the Secured Party under those provisions shall be reduced to the extent that the Security Agent has received payment in full of the corresponding amount under the Parallel Obligation.

By establishing this procedure, a new obligation is created between the Debtor and the Security Agent, obligation which shall then be secured by the Spanish Security. If the creditors wish to trade the original debt, they may be able to do it with no need to amend the Spanish documents. If the Secured Obligation is breached, the Agent would enforce the security in order to collect the Parallel Obligation and will distribute it among the creditors in the amount agreed (as traded). Note that the use of Parallel Debt in Spanish deals is very much in its starting point and there has been no Court precedent which may ensure its validity and enforceability. Also, its registration may be complicated due to registrar’s lack of familiarity.

(b) Renegotiating the deal... renegotiating the security?

In general terms amending the principal Facility will imply adapting and amending the security in order to reflect the changes made to the Secured Obligations. Three principles must be followed here: (i) if the Secured Obligation is extinguished, the
security is automatically extinguished, (ii) if the Secured Obligation is increased, the security must be amended in order to reflect the new Secured Obligation and (iii) if the Secured Obligation is reduced, pro tanto is the Security reduced. As a general advice it is recommendable to amend and/or ratify the security upon an amendment of the Secured Obligation. In any event Spanish counsel should be sought in order to ensure that upon renegotiating the deal any ranking of the security is duly maintained.

(c) Release of the Security

As mentioned above, the release of the Secured Obligation implies an automatic release of the Security. However, the fact that certain Security is registered and that certain formalities have been made in its perfection (such as transfer of possession) makes it recommendable to enter into termination agreements and filing the same to the registry. As a general rule, termination of Mortgages are filed to the Land Registry, termination of pledges over Shares are accompanied by return of the possession of the Share certificates and termination of pledges over receivables are accompanied with new notices stating that the receivable is no longer pledged. Formalities are also recommendable in order to allow the company to grant “clean security” to a new financier. The procedure of release of the Security and/or any costs linked to such release are usually agreed by the Grantor and the Secured Parties in the deed of security.

3.4. The default/insolvency scenario

(a) Default and Enforcement of Securities

We have been frequently requested by Lenders to provide them with a brief picture of what an enforcement procedure of securities would entail in Spain, as they may be very different from standard procedures in other jurisdictions where Secured Parties are, as a general principle, entitled to appropriate the secured assets and to freely sell them in the market without the need of following a standardised statutory procedure.

The aim of this section is to provide the reader with the main aspects of the market practice of enforcement of securities in Spain, which are: (i) notarial enforcement, for pledges (shares, receivables, credit rights); (ii) court enforcement, for real estate Mortgages; and (iii) financial securities over listed shares or deposits made in cash.

(b) Notarial enforcement of Pledges

Upon default of the Debtor, and unless otherwise stated in the security deed(s), the Secured Parties will be entitled to enforce the pledge through a Spanish Notary (Article 1872 of the Civil Code) by sending an enforcement request, jointly with the conditions for the auction. Once such enforcement request has been submitted to the Notary, the procedure of enforcement should be the following:

The Public Notary shall announce and set a time, place and date for a public auction to take place;

The Notary will summon the Secured Party and the Grantor to the auction;

The auction will take place on the date, time and place established by the Notary (or agreed by the Notary and the Secured Party);

If during the first auction the secured assets are not sold to a bidder or the best offer made by a bidder is lower than the reference value established for the first auction, the Notary will announce a second auction;
If no bidders attend the second auction or the assets are not sold due to all bids being lower than the reference value established for the second auction (which will be lower than the reference value established for the first auction), the secured creditor will be entitled to become the owner of the secured assets and shall give a discharge note to the Grantor for the full amount of the debt.

Please note that the above are general provisions set out in the Civil Code. It is also general practice to establish and to set out in the security documents the terms and conditions of the auctions, which should be followed by the Notary unless they are illegal or they contravene in any manner any regulations.

The Secured Parties should ensure to include in the security documents, provisions regarding (a) the appointment of representatives of the Grantor; (b) rules of selection and appointment of the Notary Public competent for enforcement; (c) grounds of opposition to the enforcement; (d) notice of auctions; and (e) dealings with expenses and delivery of the price to the designed Agent.

(c) Special case: “financial securities”

In respect of the so called “financial securities” ("garantías financieras"), i.e. those securities over listed shares, other financial rights or deposits made in cash, granted in favour of an established financial institution, there is a special procedure of enforcement set forth in the Royal Decree-law 5/2005, whereby the Secured Party may directly dispose or take over the property of the secured asset (listed shares or similar financial rights), or compensate the value of the debt with the secured amount in cash. For this to be applicable, the deed of pledge must establish (i) an express agreement to entitle the Lender(s) to enforce through this procedure; and (ii) the procedure of valuation of the secured assets upon enforcement.

(d) Court Enforcement of Mortgages

The Spanish Civil Procedure Rules ("SCPR") provide with a fast-track proceeding 2 which enables Secured Parties to enforce a registered Mortgage with fewer requirements than those imposed to ordinary proceedings (which may entail months of litigation and delays). For Secured Parties to enforce a Mortgage through this fast-track proceeding, the following requirements shall be met: (i) the Mortgage must have been executed in a public deed; (ii) the deed of Mortgage shall set out the reference value of the secured asset (i.e. the auction price); (iii) the deed shall set forth a notification address of the Grantor, to guarantee that the Grantor is promptly informed about the enforcement of the Mortgage and is able to receive any relevant court documents; (iv) the Grantor should have been notified of the intention of enforcement and given a cure period of at least ten (10) working days (which should be witnessed through a public deed) to satisfy the amount of the debt that is in default and triggers the right of the Secured Party to enforce the Mortgage.

Briefly, the procedure of enforcement would have the following steps: (i) service of notice of enforcement on the Grantor; (ii) submission of the request of enforcement ("demanda ejecutiva") to the court which will notify the Grantor if the notification has not been carried out by the Secured Party; (iii) once the request has been submitted to the court, and all the aforesaid requirements have been met, the court will carry out all the relevant enquiries with the relevant registries (the court will mainly check that the mortgage is duly and lawfully registered); and (iv) the court will schedule a day to auction the secured assets, after 30 days from reception of all the above documents and the obtaining of the results of the aforementioned enquiries. After the auction the Secured Parties will be satisfied from their credits and the

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2 Sections 681 to 698 SCPR
remaining proceeds would be paid to the Grantor, except if there is a pledge over the surplus (see point 3.1.(e) above).

(e) The initiation of the insolvency procedure

In 2003 Spain reformed its previous existing insolvency regulations through the Insolvency Act, which entered into force on September 1st 2004. The reform purported to unify and adapt all existing insolvency rules and procedures, introducing a single restructuring scheme called “Concurso”. This proceeding is flexible and offers various courses of action in response to the insolvency of a Debtor. The solution is adapted to the individual needs of the financial status of the Debtor, and takes the form of either an agreement or liquidation.

Further to the initial reform carried out in 2003 the economic evolution and the gloom triggered by the global recession that kicked off in 2008, the Spanish regulators had to dynamically adapt the Insolvency Act to the crisis situation to endeavour the most rapid recovery of the Spanish economy and the strengthening of the market, whilst providing the market operators with a rapid answer to the challenges of this new situation. With these framework in mind, in March 2009 a new regulation was enacted, the Regulation 3/2009. With regards to Insolvency Proceedings, the Regulation 3/2009 aims to ease the refinancing of the Debtor’s debt in order to avoid filing for insolvency.

To begin with, the Insolvency Act foresees the possibility of the insolvency proceeding being initiated by the Debtor (voluntary insolvency proceeding) or by its creditors (compulsory insolvency proceeding), there being remarkable differences between both alternatives:

(i) Voluntary insolvency proceeding

The Debtor must apply for insolvency proceeding within the two months following the date in which it had known or should have known its insolvency, either current or imminent (possibility to anticipate the insolvency situation). In this scenario, there is a presumption that the insolvency exists and the Debtor keeps the management of its assets, subject to the intervention of the insolvency administration.

(ii) Compulsory insolvency proceeding

A creditor applies for the insolvency proceeding; the creditor must justify the need for the insolvency proceeding on the basis of any of the reasons established by the Act (among others, seizures of debtor’s assets, general failure to meet debtor’s payment obligations, failure to comply with tax or Social Security obligations). In this scenario, the Insolvency Act provides for the suspension of the management of the assets, which shall be carried out by the insolvency administration.

(f) Stand by Period for Insolvency

Notwithstanding point (i) above, the Regulation 3/2009 introduced a new section to the Insolvency Act (Section 5.3) which sets forth a period that for the purposes of this article we will call “Stand by Period”, whereby the Debtor although being in technical insolvency, is not required to file for insolvency. In this respect, the duty to petition for an order opening the insolvency proceeding shall not be required of a Debtor who, in a state of present insolvency, has commenced negotiations to obtain adhesions to an early proposal of composition/creditors’ agreement and, within the two-month period mentioned

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1 Royal Decree 3/2009, of 27 March, or urgent measures regarding tax, finance and insolvency triggered by the current economic environment.
in 3.4.(e).(i) above, makes this known to the competent Commercial Court to declare insolvency proceedings open in its regard. After the elapsing of three months from informing the Court of the Stand by Period, the Debtor, must petition for a declaration opening the insolvency proceeding within the following month if insolvency conditions still exist.

This Stand by Period jointly with the possibility to enter into Restructuring/Refinancing Agreements (see Section 3.4.(k) below) protecting certain transactions from the risk of rescission, gives creditors and Debtors a legal certainty and provides the Debtor with the possibility to avoid insolvency and to continue carrying out its business.

(g) Event of default and waiting period

Pursuant to section 61.3 of the Insolvency Act, clauses granting a faculty to terminate a contract or foreseeing the extinction of a contract by reason only of the declaration of insolvency of any of the parties thereto shall be considered as non-existent. This is, a Secured Party may not claim a default due to the insolvency of its Spanish Debtor. This limitation will also apply if the contract is a foreign law agreement (to the extent the Debtor is Spanish) since the provision is of an insolvency nature and applicable to all Spanish insolvent companies.

It is also very relevant to note that the Insolvency Act does not allow separate enforcement of guarantees in rem such as those mentioned above from the time the insolvency proceedings have been declared until approval of an arrangement with the creditors of the Debtor whose content does not affect the exercise of this right or property or until one (1) year has passed after the declaration of insolvency proceedings without the liquidation period having been initiated (see point 3.4.(j) below).

(h) Ranking of credit rights

Pursuant to Section 89 of the Insolvency Act credits of an insolvent company may be privileged, ordinary or subordinated. Privileged credits are also divided between specially privileged (if they affect certain particular assets of the company) or generally privileged. The general provision is that those credits which are not considered privileged or subordinated pursuant to the Insolvency Act are to be considered ordinary. Also, the Insolvency Act defines certain credits as Credits Against the Estate (or “Créditos Contra la Masa”).

(i) Credits Against the Estate

Credits Against the Estate (“CAEs”) are listed in Section 84 of the Insolvency Act and comprise certain expenses of the insolvent Debtor due to the entering into the insolvency procedure, payment of salaries corresponding to the period of thirty (30) days before the declaration of insolvency and others relating to agreements rescinded within the insolvency procedure.

In general terms, CAEs are satisfied before any other credit of the insolvent Debtor, but proceeds used from assets securing Specially Privileged Credits may not be used for such purpose.

(ii) Specially Privileged Credits

In broad terms, specially privileged credits (“SPCs”) are those secured by rights in rem, such as Mortgage and Pledges loans, credits secured by pledge or other types of security (including pledges over credit rights). SPCs are senior rights as regards the proceeds obtained from the foreclosure of the asset and, if the value of the asset is not sufficient to satisfy the SPC, the remaining amount shall be paid pro rata with the ordinary credits (Section 157.2 of the Insolvency Act).
(iii) Generally Privileged Credits

Generally Privileged Credits ("GPCs") are listed in Section 91 of the Insolvency Act and correspond to certain labour and tax credits, credits for torts and credits owned by the creditor that has requested the insolvency (to the extent it is not subordinated) up to a quarter of its value.

GPCs are to be satisfied only after the CAEs have been satisfied.

(iv) Ordinary Credits

Credits which are not CAEs, Privileged Credits nor Subordinated Credits are considered as ordinary credits ("OCs"). OCs are to be satisfied after CAEs, SPCs and GPCs have been settled and pro-rata with those SPCs which have not been settled in full with the proceeds of their corresponding asset.

(v) Subordinated Credits

Subordinated credits ("SCs") are those that rank subordinated to OC and are listed in Section 92 of the Insolvency Act. Among the list of SCs the following are of special importance: credits that the parties wish to consider as subordinated (to all other credits of the company and not only to specific creditors), credits due to interest (including default interest but excluding those secured by a right in rem up to the value of the asset) and those credits owned by parties specially related to the insolvent.

Who is specially related to the insolvent? Section 93 clears up the question by stating that, as regards a Debtor being a corporation, certain shareholders owning more than 10% of an unlisted insolvent corporation (or 5% if the corporation is listed), directors and corporations belonging to the same group that the insolvent company and their shareholders. It is also important to note that the assignees of credits belonging to any specially related entity shall also be subordinated unless the assignment took place before the two (2) years preceding the declaration of insolvency.

Finally, subordination prevails over SPCs and, therefore, if an SC is secured by a right in rem, in accordance with Section 97 of the Insolvency Act the insolvency judge will declare the Security extinguished.

(i) Rescission? Hardening Periods in the Insolvency Act

Article 71 of the Insolvency Act allows for the possibility of rescinding certain acts of the Debtor carried out during the two (2) year period preceding the declaration of insolvency, on the grounds that those acts are prejudicial to the insolvent estate and regardless of whether those acts had been performed with the aim of deceiving the interests of the creditors or not. Upon the insolvency of a Spanish party (an entity or an individual) being declared, those actions which are judged detrimental to the estate of the insolvent party and which have been carried out during the two (2) years preceding such date, may be rescinded even in the absence of fraudulent intention.

The dispositions of Article 71 the Insolvency Act are aimed to: (i) ensure that the insolvent’s estate is not reduced to the detriment of its creditors; and (ii) to safeguard the “Par Condition Creditorum” in insolvency.

The detriment to the estate is presumed iuris et de jure (i.e. without possibility of providing evidence to the contrary) in the case of actions of disposal without consideration (except for usual liberalities), and payments or other actions aimed at discharging obligations with an original date of maturity subsequent to the date of the insolvency declaration.
Furthermore, detriment is presumed *iuris tantum* (i.e. unless evidence is provided to the contrary) in the event of (i) disposal actions carried out in favour of a party related to the insolvent party; and (ii) the creation of securities *in rem* in favour of pre-existing obligations or of new obligations replacing previously existing ones. That provided in (ii) above is causing certain interpretation concerns as regards its application in the promissory security since, if the promised Security is finally granted, such Security will be securing “pre-existing obligations”.

In the case of actions not included in any of the above two categories, the detriment must be proven by the person bringing the action of rescission.

The effects of rescission under Article 71 of the Insolvency Act are: (i) the ineffectiveness of the act; and (ii) the restitution of the goods or services provided by the parties involved in the act that is rescinded, plus interests and fruits, if any. If after rescission is declared, the Debtor is no longer available to restitute the creditor with the goods or services provided the creditor shall have a claim against the estate of the Debtor, that will be paid simultaneous to integration of the assets and rights subject to the rescinded act, except if the court order declared bad faith of the creditor, in which case the creditor will have a subordinated claim against the Debtor.

**(j) Enforcement of Securities in Insolvency**

One of the most important effects of the declaration of insolvency of the Debtor is regarding the enforcement of securities. Section 56 of the Insolvency Act establishes that no Creditor holding securities *in rem* shall be entitled to enforce any of such securities against the Debtor until a Creditors’ Agreement has been reached, or until one year has elapsed from the date of declaration of the insolvency proceeding without the winding-up of the debtor having commenced.

In the same manner, if the enforcement of a security had already been commenced when the declaration of insolvency of the Debtor is ordered by the court, such enforcement shall be suspended, except if the announcement(s) of auction of the goods or rights secured had already been published at the time of declaration of insolvency, and the enforcement does not affect goods or rights that are necessary to continue the Debtor’s professional or business activity.

**(k) Restructuring/Refinancing Agreements**

Before Regulation 3/2009 entered into force, Lenders faced a high risk of rescission when entering into restructuring or refinancing agreements with a Debtor whose financial position showed indicators of insolvency. Regulation 3/2009 establishes certain requirements which, if met, would eliminate the rescission presumptions of certain refinancing or restructuring agreements (both hereinafter referred to as “RAs”), including any Securities linked to those.

To provide the reader with a quick snapshot of the regime of RAs under the recent amendments of the Insolvency Act, the risk of rescission of Article 71 will be substantially mitigated in respect of RAs that comply with the following requirements:

That any RA shall either: (i) substantially increase the funds available to the insolvent; and/or (ii) amend the terms of the debt that is to be re-negotiated by means of the RA by, for instance, extending the maturity of a credit, etc;

That any RA shall be a part of a viability plan of the insolvent company for its short and medium term;

That the RA is approved by creditors amounting to, at least 3/5 of the liabilities of the debtor;
That the RA is executed before a Spanish Public Notary and recorded in a public deed; and

The RA and the Viability Plan shall be signed off by an independent expert appointed by the Companies Registry, who will issue a report assessing: (a) if the information provided by the parties (in particular, by the insolvent company) is sufficient; (b) that the RA is reasonable and the viability plan is sensible; and (c) any securities guaranteeing the RA shall be proportional to the usual market practice.

London, September 2010