IFLR
INTERNATIONAL FINANCIAL LAW REVIEW

GLOBAL HIGH YIELD REPORT 2014

Guest edited by Ward McKimm

KIRKLAND & ELLIS LLP

Spain

GOMEZ-ACEBO & POMBO
www.gomezacebo-pombo.com

Fernando de las Cuevas and Ferran Foix Miralles
Gómez-Acebo & Pombo

Section 1: STATUTES AND REGULATION

1.1 Briefly explain how you would categorise the high yield market in your jurisdiction: nascent, moderately advanced or very advanced? And why?

We could categorise the high yield market in Spain as moderately advanced. The impact of the global financial crisis, the restructuring of the Spanish financial sector and the new capital requirements for banks has caused a significant decrease in available bank credit, which has resulted in Spanish entities searching for alternative sources of financing. In this context, the perception of high yield markets as a potential source of financing has been growing, and in recent years several Spanish issuers have tapped into that market. However, there is still a long way to go in terms of developing a local investor market and educating potential issuers.

1.2 Is there a market for high yield offerings in your jurisdiction in which the high yield notes are governed by local law versus the more typical New York law?

In Spain, there is a regulated secondary market for fixed income securities called AIAF, and a multilateral trading facility for institutional investors called MARF, launched in October 2013. Although MARF is still a very recent initiative, it is expected that it will increasingly be used by medium-sized users to tap the institutional market with debt securities. However, the local investor market for high yield is still small and most high yield offerings made by Spanish entities until now have been placed abroad, mainly in the US, and are governed by New York or English law.

Section 2: DISCLOSURE

2.1 What additional disclosure or other information (if any) would a high yield issuer be required to provide in connection with an offer and sale of high yield notes to sophisticated/institutional investors in your jurisdiction over and above what would be included in a prospectus for such notes prepared in connection with an offering to be registered with the US Securities and Exchange Commission or a prospectus that satisfied the requirements of the EU Prospectus Directive?

Most high yield offering by Spanish entities have been made under Rule 144a and Regulation S. The latter is becoming the market standard for international offerings of high yield securities by Spanish entities. Disclosure standards for local private placements of debt in Spain are much lower than those required for 144a or Regulation S offerings or under the EU Prospectus Directive. As a high yield local investor market develops, they may come closer to that of Regulation S deals.

2.2 What regulatory filings must be made in your jurisdiction in connection with a public offering of high yield securities? And what information must be included in such filings or made available to potential investors over and above what would be included in a prospectus for such notes prepared in connection with an offering to be registered with the US Securities and Exchange Commission or a prospectus that satisfied the requirements of the EU Prospectus Directive?

See section 3.1

Section 3: PUBLIC AND PRIVATE OFFERINGS

3.1 Briefly outline, with respect to any public offering of high yield notes, any registration and filing process in your jurisdiction, including reference to the stages necessary and time for a typical review process to conclude. Please also indicate whether an offering may commence while regulatory review is in progress.

Public offerings of high yield notes in Spain, and the listing of debt securities in a Spanish secondary regulated market (such as AIAF), require the filing of a prospectus for its prior approval by the Spanish securities exchange commission (*Comisión Nacional del Mercado de Valores* or CNMV) and its registration. The CNMV will verify that the prospectus contains all necessary information concerning the issuer and the securities for investors to make an informed investment decision and that it complies with the applicable regulations (mainly EU Prospectus Directive regulations).

Within a maximum period of 10 business days from submission, the CNMV should notify its decision regarding the approval of the prospectus or any comments or additional requests of information. In the latter case, the 10 business days are counted from the submission of the complete or revised package.

The prospectus cannot be published or in any manner be made available to the public until it has been approved by the CNMV. However, publicity of a public offering may be made at any time, even before approval of the prospectus by the CNMV. Upon approval, the prospectus will be registered in the administrative registry of the CNMV, and may be made available to the public as soon as practicable and, in any event, within a reasonable time before admission to trading of the offered securities.

3.2 Briefly outline the publicity restrictions that apply to a public offering of securities and any restrictions in place on the ability of the underwriters to issue research reports.

Marketing communications in relation to investments and securities should be clear, sufficient, objective, not misleading and clearly recognisable as publicity. They should also declare that a prospectus has been or will be published and be consistent with it. Any relevant information provided to qualified investors or special categories of investors should be included in the prospectus or in a supplemental prospectus. All marketing materials should be kept by the offeror and underwriters and be made available to the CNMV at its request.

Documentation or information provided in presentations to analysts or institutional investors during the placement period is generally not considered to be publicity under Spanish regulations. Neither are analysts' periodical publications on securities, including research reports and investment recommendations.

3.3 Please explain the rules in place (if any) in your jurisdiction (other than any EU, UK or US rules) for the private placing of high yield notes, with reference to the procedures that must be implemented to effect a valid private placing and what information must be made available to potential investors in connection with a private placing of high yield notes.

In Spain, the private placement exemption applies to securities offerings that comply with any of the following requirements: (i) are exclusively directed to qualified investors (eligible counterparts, professional clients and certain individuals or small and medium enterprises that have expressly requested to be considered as such); (ii) are directed to less than 150 natural or legal persons per member state, excluding qualified investors; (iii) are directed to investors who acquire securities in at least €100,000 ($140,000) each per offering; (iv) have a unit nominal value of at least €100,000; and (v) their total amount in the EU is less than €5 million (over a 12-month period).

Private placements of debt securities do not require filing or registration of a prospectus in Spain. The rule is that any relevant information provided to qualified investors or special categories of investors should be provided to all investors to whom the offer is addressed. In many cases, no prospectus is delivered to potential investors, just a note with the terms and conditions of the securities. For local private placements of high yield notes in Spain there is still no disclosure standard.

3.4 Are there any specific domestic rules apply to offerings of securities outside your jurisdiction made by an issuer domiciled in your jurisdiction?

No. However, certain requirements or limitations under Spanish law apply to the issuance of debt securities and have influenced the manner in which high yield offerings are structured. Examples of limitations are the prohibition of Spanish limited liabilities companies (*sociedades de responsabilidad limitada*) to issue or guarantee debt securities and the limitation of the amount of debt securities that can be issued by Spanish entities, with some exceptions, to the amount of their equity (mainly, share capital plus reserves).

Such requirements and limitations have resulted in Spanish entities often using foreign subsidiaries, holding companiess or orphan structures to issue debt securities. However, the Spanish government is working on the draft bill for the promotion of corporate financing, that may lift some of the limitations and make the requirements to issue debt securities more flexible for Spanish entities. If this draft bill is passed, the use of such structures may no longer be required.

Section 4: DOCUMENTATION FORMALITIES, GOVERNING LAW AND GOVERNMENT APPROVALS

4.1 Briefly explain any issues or requirements in your jurisdiction relating to the selection of New York law (or English law, in the case of intercreditor agreements) as the governing law in relation to:
a) the indenture governing an issuance of high yield notes;
b) the purchase agreement;
c) the intercreditor agreement;
d) guarantees.

Generally, it is possible to have the notes, the guarantees and related agreements governed by a foreign law (namely, New York law or English law), other than *in rem* guarantees (such as security interests or mortgages) when the collateral is located in Spain. However, there are certain aspects of an offering by a Spanish issuer or guarantor must be governed by Spanish law.

For example, certain corporate requirements and formalities under Spanish law need to be observed when the issuer or the guarantor is a Spanish entity, such as those regarding capacity, required corporate approvals and, with some exceptions, the recording of the indenture in a notarised public deed that should be registered with the Mercantile Registry.

Spanish law also requires the creation of a bondholder syndicate and the appointment of a commissioner for purposes of protecting bondholder interests. There is debate about whether this requirement is mandatory when the securities are placed abroad. In practice, it is standard to have it, except for Securities and Exchange Commission-registered offerings. The draft bill mentioned above may limit such requirement to securities offered or traded in Spain.

Spanish Insolvency laws apply to the insolvency of a Spanish issuer or guarantor. This in practice means that the Spanish insolvency regulations will govern the ranking of the notes and guarantees when insolvency proceedings (*concurso de acreedores*) are initiated.

4.2 Please describe any local law limitations (if any) on an issuer domiciled in your jurisdiction with respect to:
a) indemnities;
b) force majeure clauses; and
c) success fees.

Certain limitations on enforcement exist under Spanish law, including, that agreements may not be terminated based on breach of ancillary obligations; or that the validity and enforceability of contractual obligations may not be left at the discretion of one of the parties. For indemnities, Spanish courts are allowed to moderate or reduce the penalty payable under any contract if the main obligation has been partially or irregularly performed.

Section 5: INTERCREDITOR AGREEMENTS

5.1 Please explain how high yield creditors' enforcement rights and ranking in this jurisdiction compare with the enforcement rights and ranking of senior lenders.

Unless otherwise provided in the terms of the notes or in an intercreditor agreement, high yield notes generally rank pari passu with other senior lenders and, in the event of insolvency, both noteholders and senior lenders will generally be considered ordinary creditors to the extent of their unsecured claims, and privileged with respect to their secured claims.

Structural subordination in high yield bonds is generally avoided by having the material subsidiaries guarantee the notes, so that noteholders may rank pari passu with senior lenders of those material subsidiaries.

Certain acceleration clauses (such as cross-default clauses) may be difficult to enforce in Spain, which could give an advantage to those claims which are governed by foreign laws that are more permissible with acceleration.

5.2 Briefly outline the typical use of liens in this jurisdiction and any issues with respect to granting second priority liens as well as timing issues in the granting of liens that may affect ranking.

Security interests have barely been used to date by Spanish issuers of high yield securities, as the granting of personal guarantees by material subsidiaries is much more common. Liens more typically used in Spanish financings are pledges on material assets, such as shares or credit rights, and mortgages.

Liens that are validly created earlier in time have priority over subsequent liens on the same collateral. Therefore, timing is of the essence in the granting of liens to protect their ranking. Second-priority liens are only entitled to residual value of the collateral after first-lien creditors are fully paid.

Section 6: GUARANTEES AND SECURITY

6.1 Briefly outline the security available over high yield debt, with reference to the documentation formalities and costs required to create, perfect and maintain such security and confirm whether or not a universal security agreement which grants security over assets can be utilised.

Mortgages should be granted or raised to public before a notary. Registration with the Spanish Property Registry is required for perfection of mortgages over real estate property located in Spain. Pledges are also granted or raised to public before a notary. Only certain pledges of a non-possessory nature can be registered with the Chattel Registry, including pledges on credit rights. Because registration sometimes provides additional protection in insolvency scenarios, it is common to structure certain pledges as non-possessory, in order to have them registered with the Chattel Registry. Registration in these cases is also required for perfection.

When the collateral is cash, securities, financial instruments or certain credit rights originated in financial entities, it is common to structure the security as financial collateral. No formality or registration is required for its perfection other than being in written form. Financial collateral may be enforced through appropriation and enjoys higher protection in insolvency scenarios.

Other formalities may be required for specific types of pledges (pledges over shares are recorded in the shareholders registry book or, if listed, in the relevant book-entry registry).

The main costs incurred in the formalisation of mortgages and pledges include notarial fees, stamp duties and public registrar fees. Stamp duties could represent between 0.5% and 1.5% of the guaranteed amount and are due if the security interest is granted in a notarial deed that can be registered in a public registry (always the case for mortgages). Notarial and registrar fees are calculated per document with reference to official tables. Registrar fees may significantly vary from one registry to the other.

6.2 Highlight any issues with securing obligations that may arise in the future.

Security interest securing future obligations or claims are valid under Spanish law, provided they contemplate a maximum guaranteed responsibility. In an insolvency scenario, pledges of future claims could potentially not be recognised with respect to claims originated after the declaration of insolvency, unless the pledge is registered in a public registry prior to the declaration of insolvency. Although this interpretation of the Spanish Insolvency Law is not accepted by some scholars and has not yet been confirmed by the Spanish courts, it is advisable to avoid this risk by granting the pledges as non-possessory and have them registered with the Chattel Registry.

6.3 Can security be granted by an entity that is neither a borrower nor a guarantor (third party security) and are there any rights of contribution, subrogation or similar that might arise as a result of granting/enforcing purely third party security that ought to be/can be waived?

Third party securities are possible under Spanish law. This type of security, however, may be more easily contested in insolvency scenarios if granted during the two-year hardening period and the grantor received no benefit from the granting of the security, or was otherwise prejudiced by it. The grantor of the third party security would be subrogated in the position of the creditor when the security is enforced, unless this right is expressly waived. This subrogation right is by law subordinated to any part of the guaranteed claim that remains unpaid after enforcement of the third party security.

6.4 Briefly outline the registration requirements, if any, applicable to security interests in this jurisdiction including any practical considerations such as the time and expense associated with registration.

See section 6.1 for formalities, registration requirements and costs for security interests. Registration in public registries might take between three days and two weeks, depending on the complexity of the security interests, the existence of any error to be amended and the diligence of the registrar.

6.5 Briefly outline any regulatory or similar consents that are required to create security over a local companies' assets.

Generally none. However, creating security interests over certain assets that are subject to regulatory supervision (such as public concessions) may require specific consents. Also, if the security interest is registered with a public registry, the registrar will perform a review of the terms and formalities of the security interest and will only register if no error is found.

6.6 Briefly, explain the downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within one group) guarantees available, with reference to the any particular restrictions or limitations (such as corporate benefit, capital maintenance rules, other). Are there any techniques typically employed to enhance credit support/guarantees that might otherwise be limited (such as debt pushdown)?

Downstream guarantees (parent to subsidiary) are generally voidance-proof in insolvency scenarios, since a benefit for the parent usually derives from it. On the other hand, upstream (subsidiary to parent) and cross-stream (between sister companies within the same group) guarantees may be more easily challenged in insolvency if they were granted during the two-year hardening period and the guarantor received little or no benefit from the granting of the guarantee, or was otherwise prejudiced by it. All such forms of guarantees can be found in high yield offerings.

6.7 Briefly explain any formalities required for guarantees to be enforceable.

No specific formalities are required. However, Spanish procedural laws set forth an executive summary proceeding for enforcement of payment obligations that, among other requirements, are recorded in public deeds.

Section 7: TAX CONSIDERATIONS

7.1 Is interest on debt tax deductible for borrowers incorporated in your jurisdiction?

Interest on debt is generally tax-deductible in Spain, other than intra-group financial expenses that are not incurred for valid economic reasons. Since January 1 2012, there is a general limitation to the tax deduction for corporate income tax purposes of net financial expenses in excess of €1 million that exceed 30% of operative profit (Ebitda – earnings before interest, taxes, depreciation, and amortisation) for the tax period. Non-deductible financial expenses can be carried forward to the subsequent 18 years. In the event that net financial expenses of a tax year are below the 30% Ebitda limitation, the difference may be used as extra deduction on top of the 30% Ebitda during the five subsequent years. This limitation does not apply to credit entities and insurance companies.

7.2 Are there any thin capitalisation rules in effect in this jurisdiction, which would impact the amount of debt that can be borrowed/guaranteed by entities incorporated there?
Thin capitalisation rules have been replaced by the general limitation to deduction of net financial expenses mentioned in section 7.1.

7.3 Are there any other important tax concerns that borrowers incorporated in this jurisdiction should be aware of?
Interest payments on debt securities made by credit entities and listed entities to non-resident noteholders with no permanent establishment in Spain are exempt from withholding tax, subject to certain requirements, such as the listing of the securities in a regulated secondary market. However, when the issuer is neither a credit entity nor a listed entity, payments of interest to non-EU residents may be subject to withholding tax, as provided in the applicable double tax treaty or, if no such treaty applies, at the current default withholding tax rate of 21%.

Fernando de las Cuevas
Partner, head of M&A, Gómez-Acebo & Pombo

Madrid, Spain
T: +34 91 582 9100
E: fcuevas@gomezacebo-pombo.com
W: www.gomezacebo-pombo.com

About the author
Fernando de las Cuevas is a master of law and bachelor of business science (University of Deusto, 1981), diploma in European studies (University of Deusto, 1981), diploma in higher European studies (College of Europe, Bruges, 1982). He obtained a research scholarship from the EFTA, Geneva (1982-1983). P.I.L. Harvard Law School (1990).

Joined Gómez-Acebo & Pombo Abogados in 1983. Foreign sssociate at Shearman & Sterling (New York) 1985-1986. Partner of Gómez-Acebo & Pombo Abogados since 1990, managing partner from 1998 to 2000. Head of the corporate and commercial Area from 2007 to 2012. He is currently head of M&A.

He specialises in banking, securities market law, collective investment institutions, M&A and family and private equity businesses.

He is a member of: Madrid Bar Association (since 1983), World Securities Law Review Board, APCIMS-EASD Legal and Tax Committee, IBA (Committees E, I and Q). His languages include Spanish, English and French.

Ferran Foix Miralles
Senior associate, banking and capital Markets, Gómez-Acebo & Pombo

Madrid, Spain
T: +34 91 582 9100
E: ffoix@gomezacebo-pombo.com
W: www.gomezacebo-pombo.com

About the author
Admitted to practice in Spain and New York, Ferran Foix Miralles has an LLM from New York University and a Bachelors (equivalent) in taxation from ESADE. He graduated in Law (J.D. equivalent) from Universidad de Navarra and he was an associate at Sidley Austin LLP from 2003 to 2008.

His specialisations include M&A, capital markets, corporate finance and private equity. He provides legal advice to international companies, financial entities and private equity and venture capital funds in domestic and cross-border M&A transactions. He has relevant and vast experience in public and private placements of debt and equity securities.

He is a member of the Madrid Bar Association and New York State Bar. His languages include Spanish, English and Catalan.