New rules on the raising of finance by issuing corporate bonds

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I. Introduction

The Spanish Business Finance Advancement Act 5/2015 of 27 April (abbrev. LFFE) amends some aspects concerning the regulated bond regime under the Spanish Companies Act (abbrev. LSC).

As is well known, the above regime not only affects "bonds" in the strictest of terms, but also any securities that recognise or create debt, provided that they are issued as a series (cf. art. 401 LSC). What is relevant, therefore, is not the name of the product (e.g., corporate promissory notes), but the fact that it issues (or covers the issue of) a number of rights, with shared characteristics, that represent aliquots of the external finance sought.

In the lines that follow we will describe the most important changes in the legislative framework for issuance or collateralisation of debt securities under the LSC, with appropriate reference to the amendments to the Spanish Securities Market Act (abbrev. LMV) that affect the issue of debt securities through public offerings and may require the issue of a prospectus and supervision by the Spanish Securities Market Authority (art. 30 *bis*, *ter* and *quater* LMV). The new regulation will affect the issue of debt securities by those entities, other than companies, that may issue, as the Debt Security Issues (non-Stock Companies Regulation) Act 211/1964 of 24 December is repealed.

II. Debt security issues by limited liability companies and maximum limit

The most important change, perhaps, is the repeal of art. 402 LSC, which prohibited limited liability companies from issuing or covering debt securities and is now reduced to the prohibition of issuing or covering the issue of convertible debt securities. Thus, the practical need of transforming into stock companies those subsidiaries of parent companies which had issued this type of debt, so as to be able to cover it, is eliminated. The issue of debt securities as an instrument of participatory financing projects is also facilitated (art. 50 LFFE).

In return, the new art. 401 LSC includes certain restrictions and requirements regarding the issue of debt securities by a limited liability company. The first one consists of establishing a maximum limit for issues by this form of company: the total amount of issues subscribed for and outstanding may not exceed twice its equity, unless the issue is covered by a mortgage, a pledge of securities, government-debt or a joint and several bond of a credit institution (cf. art. 404 LSC "Issue security").

This is a provision that seeks to prevent excessive reliance by limited liability companies on this type of indebtedness, although the form-related difference justifying the elimination of the aforementioned quantitative limit provided in art. 405 LSC for close stock companies and the non-existence of such limit in respect of listed companies or credit institutions (art. 510 LSC and 2nd Additional Provision of Act 10/2014 of 26 June) is hard to fathom. Whether or not this elimination should drag along the veto on share capital reductions under art. 411 LSC is debatable as it depends on which is the position adopted in respect of its objective and subjective scope of protection.

The second requirement involves the strengthening of control over the minimum correspondence between capital, on the one hand, and assets and liabilities, on the other. Limited liability companies that have issued debt securities and approve a share capital increase by way of non-cash consideration will be subject to the measurement rules provided in arts. 67-71 LSC for stock companies. This requires the involvement of independent experts to measure the consideration given, but where excepted by law, as well as to comply with legal requirements under art. 72 LSC in respect of acquisitions for consideration subsequent to a share capital increase.

Regarding the prohibition on limited liability companies of issuing convertible bonds, it seems to be justified by the closed nature of this legal form and the prohibition of circulation by the technique appropriate to shares (art. 92(2) LSC), which moreover does not sit well with the desirable and perhaps necessary negotiability of this type of hybrid financial instrument. The LFFE does not however prohibit the issue of warrants, although it is clear that they cannot be attached to debt securities.

III. Procedure and competent body

The authority to decide on the issue or collateralisation of non-convertible debt securities is passed from the general meeting to the governing body, unless otherwise provided in the articles of association (art. 406(1) LSC). Foreseeably, at least in listed companies, articles that normally conferred this authority to the general meeting will be the subject of review.

The general meeting of shareholders is of course still competent to approve the issue of debt securities convertible into shares or the issue of debt securities granting a share in profits (arts. 414 and 406(2) LSC). As for the latter, the general meeting is not empowered to issue any debt securities that have their yield pegged to the company's profits, but only those which precisely grant a "share in profits". Although the Act only refers to the stock company, we believe that such power will also rest with general meeting of limited liability companies issuing (non-convertible) profit-sharing debt securities.

The problems inherent in the delegation to directors of the adoption of resolutions on the issue of convertible debt securities in unlisted stock companies must still be resolved through an interpretation of arts. 414, 416 and 417 LSC in conjunction with the rules on authorised capital (art. 297(1)(b) LSC). The difficulties related to the calculation of and information on anti-dilution formulas arising from the necessary involvement of the general meeting to exclude pre-emption rights in close companies also remain, especially when setting out a fixed conversion (art. 417 LSC).

Lastly, one should note the introduction of certain requirements in addition to the execution of the deed of issue of covered debt securities (art. 407) and the elimination of the prohibition on placements prior to registration with the Register, where appropriate (cf. arts. 30 *ter* and *quarter* LMV) as well as publishing the issue announcement in the Official Journal of the Register of Companies (abbrev. BORME) (alteration of art. 407 and repeal of art. 408 LSC); the foregoing without prejudice of additional announcement obligations in the event of issue of convertible debt securities with pre-emption rights (arts. 304-306 LSC).

IV. The Standing Committee of debt security holders and private international law rules

The organisation of debt security holders through a Standing Committee and their membership of the same is required only where provided by special legislation (art. 403 LSC).

The new art. 30 *quater* provides that the regulated standing committee of bondholders (i.e. debt security holders) regime under the LSC shall apply to the issue of debt securities of the nature of a public offering where: i) its terms and conditions are governed by Spanish law or the laws of a State which is neither a member of the European Union nor a member of the Organisation for Economic Co-operation and Development and ii) it takes place on Spanish territory or its admission to trading occurs on a Spanish official secondary market or in a multilateral trading system established in Spain.

The amendment tries to thus solve the private international law-related problems posed by the application of foreign investor protection rules when they were inconsistent with Spanish legislation on the subject of standing committees.

It is in light of the above that we must consider the new article 405 LSC, which lays down rules for the resolution of conflicts of law in the issue of bonds by Spanish entities abroad.

The Spanish law shall govern in respect of the capacity, competent body and terms of adoption of the issue resolution, while the rights of debt security holders against the issuer, its forms of collective organisation (in reference to the Standing Committee) and the debt security repayment and redemption system shall be governed by the law to which the issue has made it subject to. In the case of convertible debt securities, the contents of the conversion right shall be governed by the foreign law that governs the issue (within the limits set out by Spanish law as the law governing the company). The value of debt security issues, the limits on conversion and the pre-emption right exclusions shall also be determined in accordance with Spanish law.

The Standing Committee will remain mandatory for debt security issues in Spain by public offering. We must therefore note the modification of provisions related to the Chairman, whose powers are significantly clipped (art. 421 LSC) as well as the flexibility of the operation thereof (art. 423 LSC). The new article 424 bis establishes the possibility of representation by another debt security holder and the prohibition of granting such representation to company directors and the new art. 424 *ter* LSC expressly sets out the need to respect the proportionality between the nominal value of the debt securities and the right to vote. Lastly, the rules on the formation of majorities are clarified (art. 425 LSC).

V. Debt securities and insolvency proceedings

The repeal of art. 410 LSC will be welcomed since it raised several problems of interpretation. The first sub-article set out the ranking of first issues vis-à-vis subsequent ones in respect of the issuer's free and clear assets. This created confusion in relation to the second sub-article, which stated that, in the case of insolvency proceedings, the relation of debt security holders' rights with other creditors would be governed by this legislation.

The priority between series caused more of a disadvantage than an advantage for the placement of debt securities and forced to neutralise the effects of subordination through additional security, usually by parent companies. Naturally, the adoption of such measures will no longer be required, without prejudice to operators wishing to establish priorities in relation to their series.

It is now clear that debt security holders are creditors who shall be classified as all others in insolvency proceedings, including issues subordinated by agreement.

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