Recent Amendments to the Spanish Insolvency Act and how these affect the ability to bind minority creditors in Spanish Restructurings

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1. Introduction

This paper intends to briefly describe the amendment to the Spanish Insolvency Act ("**SIA**") approved by the Spanish Parliament on 19 September 2013 (the "**Amendment**"). Within the Amendment, we want to highlight two issues: **(i)** the changes introduced in Court homologation proceedings (see definition below), and **(ii)** the newly introduced out-of-court settlement procedure. This memorandum does not intend to be comprehensive and only points out some of the issues contained in the Amendment. Proper legal advice should be sought before taking any action.

2. Overview Of Refinancing Agreements And Court Homologations

Refinancing Agreements

A refinancing agreement, within the meaning of the SIA (the "**Refinancing Agreement**"), is a transaction which meets the following conditions: **(i)** the Refinancing Agreement aims at substantially increasing the funds available to the debtor and/or modifying the terms of the debt that is to be re-negotiated by means of the Refinancing Agreement; **(ii)** the Refinancing Agreement is a part of the debtor's short and mid-term viability plan; **(iii)** the Refinancing Agreement has been approved by creditors representing, at least, 3/5 of the debtor's total liabilities; and **(iv)** an independent expert appointed by the Spanish Register of Companies (*Registro Mercantil*) has issued a favourable report assessing, among other issues, the sufficiency of information provided, the reasonability of the Refinancing Agreement, the proportionality of its security and the feasibility of the viability plan.

From a formal standpoint, the Refinancing Agreement must be executed before a Spanish Notary Public and recorded in a public deed to which the debtor must attach all documents supporting the reasons for refinancing as well as those proving fulfillment of the requirements mentioned above.

The concept of Refinancing Agreement was originally included in the SIA in order to afford a safe-harbour of sorts against claw-back risks (the possibility of certain acts being rescinded within a 2-year period preceding the opening of insolvency proceedings, on the grounds that such acts are detrimental to the insolvent's asset pool) in Spanish refinancings/restructurings. However, they now also have relevance for the purpose of potentially binding creditors though the use of Court homologations.

Court Homologations

Court homologations ("**Court Homologations**") are a mechanism to force dissenting unsecured financial institutions into a Refinancing Agreement. Pursuant to it, any Refinancing Agreement that is compliant with the requirements set out above and is approved by financial institutions holding a certain percentage of the debt, can be homologated by the Commercial Court of competent jurisdiction ("*homologación* *judicial"*); and, through such homologation, some of its provisions (particularly, the time extension agreed with such financial institutions) can be forced onto non-consenting unsecured financial institutions.

How the Amendment affects Court Homologations

The Amendment includes, among others, the following changes to Court Homologations:

(i) Majorities´ requirement

The percentage of debt held by financial institutions required to force unsecured financial institutions is reduced from 75% to 55%. Therefore, once a Refinancing Agreement has been homologated, stays of payment accepted by 55% of the total debt held by financial institutions can be extended to the other 45% of absent or dissident unsecured financial institutions, provided such extension does not involve a disproportionate sacrifice (and that some other requirements are met).

(ii) Quorum

It was unclear before the Amendment whether the Refinancing Agreement to be homologated required both the 3/5 of total debt approval included in the definition of a Refinancing Agreement and the (current) 55% approval mentioned above or if, on the contrary, only the latter was required. In the wake of some relevant court judgments (among others, Judgment of the Commercial Court of Barcelona dated 5 July 2012 / Judgment of the Commercial Court of Barcelona dated 28 June 2013 / Judgment of the Commercial Court of Barcelona dated 23 January 2013 / Judgment of the Commercial Court of Madrid dated 14 March 2013 / Judgment of the Commercial Court of Madrid dated 17 December 2012), the Amendment now clarifies that only the specific quorum (55% of the debt held by financial institutions) is required.

3. Overview Of The Out Of Court Settlement

According to the SIA (as amended pursuant to the Amendment), an out of court settlement (the "**Settlement**") can be applied, barring certain exceptions provided under the Amendment, by companies that comply with the following requirements: **(i)** the company is in a state of insolvency; **(ii)** the company meets the following conditions: a number of creditors lower or equal to 50; liabilities lower than €5 million (to be duly proved by the company's relevant balance sheet); assets valuation lower than €5 million (although the law does not expressly clarify if all these three conditions should be met, various Court rulings applicable to similar circumstances seem to support the idea that only one of them is needed); **(iii)** the company has sufficient liquid assets to satisfy the costs of the procedure; and **(iv)** the company has equity and expected revenue figures which reasonably allow it to reach an agreement with its creditors.

In order to reach a Settlement, the Amendment introduces the figure of the insolvency mediator (the "**Mediator**"), who will be appointed by the Register of Companies or, in some cases, a Notary Public, and whose main role is to drive forward the Settlement procedure. The appointment of the Mediator and the Settlement procedure are conceived as occurring out-of-court and before a winding up petition has been presented.

The Settlement can involve **(i)** a maximum stay of 3 years; and **(ii)** a maximum haircut of 25% of claims. In order to homologate a Settlement, approval of creditors representing 60% of the total debt is required, unless the deal consists on debt for asset swaps, in which case it must be approved by 75% of the total debt and by the creditors with security over assets transferred. Total debt has the meaning here of debt affected by the proposed Settlement; secured creditors would only be affected if they so agree. In any event, the Settlement shall not affect government receivables.

The Settlement may be contested within a period of 10 days following its publication, although the grounds for such challenge are primarily limited to procedural errors or a disproportionate haircut/stay.

Finally, in the event that the Settlement is not approved pursuant to the majorities mentioned above or, if approved, it is not complied with, the company will go into insolvency with the particularity that a liquidation procedure (rather than a composition of creditors procedure) will follow straight after with the appointment of the Mediator as liquidator. In this situation, the claims held by unsecured creditors who, having received the notification of the creditors' meeting, have neither attended nor duly stated their approval or opposition, shall be classed as subordinated. In contrast, creditors who attended the meeting and signed the Settlement shall be automatically recognised without having to serve any further communication.

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