Credit and Restructuring Considerations

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Reflections on ICO-backed refinancing and financing

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In recent months, following the adoption of Royal Decree-law 8/2020 of 17 March on urgent extraordinary measures to deal with the economic and social impact of COVID-19 ("**RDL 8/2020**"), Spanish financial institutions have been very active in corporate financing with part-guarantees provided by the Ministry of Economic Affairs and Digital Transformation and managed by the State-owned economic development bank *Instituto de Crédito Oficial* ("**ICO**").

This financing, which has provided liquidity to many companies (both SMEs and large enterprises), has been structured on the basis of a maximum term of five years, and normally includes a grace period of one year from the date of granting. Thus, most companies will begin their repayment schedule as from the second quarter of 2021. The general feeling in the market is that many of these companies will have difficulties in meeting their payment obligations with their financial creditors, those arising from this ICO-backed financing ("**ICO COVID-19 Financing**") as well as the rest of their financial obligations.

This paper includes some reflections on the compatibility of ICO COVID-19 Financing with the refinancing procedures many companies are likely to have to undergo in the coming months.

Refinancing of pre-existing debt

One of the main issues to be resolved is precisely the possibility of c**oexistence of ICO COVID-19 Financing with the refinancing of pre-existing debt**. This issue, which has been the subject of debate in recent months, is raised by the wording of the third paragraph of Article 9 of the agreement (the "**Agreement**") entered into by and between the ICO and the financial institutions, which states the following: "*the (financial) institution undertakes and obligates itself to not refinance or restructure operations entered into with the self-employed person/client before 17 March 2020*".

A literal interpretation of this statement could lead to the conclusion that, if the company's pre-existing debt is refinanced, the financial institution benefiting from the ICO guarantee would be in breach of its obligations under the Agreement and would therefore be at risk of forfeiting the guarantee.

In contrast to this literal interpretation, the following construction is also possible:

— It is a fact that the refinancing (or mere novation) of pre-existing debt at the same time as the granting of ICO COVID-19 Financing is often essential precisely to adapt the debt structure and repayment schedule to the new debt (guaranteed by the ICO) to the new scenario (new business plan) that is being considered.

— The same reasoning applies to post-ICO COVID-19 Financing (which is, according to the Agreement itself, emergency financing whose timescales, by definition, will always be much shorter than those required to complete a whole refinancing procedure).

— Thus, if refinancing after or at the same time as the granting of ICO COVID-19 Financing involves, for example, scheduling of existing debt to facilitate repayment of ICO COVID-19 Financing, would it make sense to withdraw the guarantee? A possible construction is that in these cases the financial institutions (beneficiaries of the ICO guarantee) that execute the refinancing of the existing debt are operating in this way to improve the chances of repayment of the ICO COVID-19 Financing without the ICO having to make good its guarantee, since, if the existing debt is not refinanced, a default on such would necessarily drag along the ICO COVID-19 Financing. Albeit without express authorisation, there is a useful management of third-party business that should not have negative consequences for the financial institution.

Without prejudice to the foregoing, and sticking to the interpretation of the compatibility of ICO COVID-19 Financing with refinancing procedures, one should not lose sight of the following premises:

— The purpose of ICO COVID-19 Financing must be that provided for in the Agreement and must not be used to refinance (repay) old debt that is not due.

— As far as possible, financial institutions should try to apply the same risk criteria (repayment schedule, guarantees) that are followed in the granting of new money financing.

Therefore, we understand that these conditions would not only prevent repayment with ICO COVID-19 Financing of old debt that is not due, but would also mean that refinancing simultaneous with or subsequent to ICO COVID-19 Financing that favours the repayment of old debt over the new ICO COVID-19 Financing could jeopardise the ICO guarantee.

That said, and in any case, we should be very cautious with this issue. Firstly because the wording of Article 9 of the Agreement is not helpful, and also because (either in the audit to be carried out in 2021 - provided for in the Agreement itself - or in the context of the enforcement of the guarantees), it seems that the ICO itself will have many an incentive to interpret this Article literally, avoiding the need to pay out the relevant sums.

If, despite the above caveat, one must go ahead with the refinancing of old debt, let us note that in a purposive approach to the prohibition to which we have been referring we would be obliged to respect (only) a *pari passu* rule, by virtue of which ICO COVID-19 Financing could not be worse off after the refinancing of old debt compared to the status quo that existed prior to that refinancing of old debt; unless the preferences of this post-ICO refinancing can be fully justified as necessary to ensure the proper payment of ICO debt.

Refinancing of ICO COVID-19 Financing

The above as regards the refinancing of pre-existing debt. However, taking a further step, **can ICO COVID-19 Financing be refinanced?** Logically the answer is yes, but if the ICO guarantee is to be maintained, the *Instituto*'s consent will be required.

How will such consent be formalised?

The answer is not obvious, because in most operations there is no express consent from the ICO for each guaranteed financing. Thus, in financing with an ICO guarantee for an amount of less than 50 million euros, there is no express prior consent or authorisation from the ICO in relation to the guarantee. This guarantee is instrumentalised by virtue of the Agreement signed with each of the financial institutions (and the procedure established therein). In fact, what the Agreement establishes in clause 10 *in fine* is the following: "*Guarantee applications which comply with the automatic validations made by Banc@ico shall be placed in the CORRECT ICO status, the guarantee being understood to be incorporated into the portfolio guaranteed by the ICO, without prejudice to the power of the ICO to subsequently exclude from the guaranteed portfolio those operations initially marked as "CORRECT ICO" where, during the Review/Checking process, non-compliance with any of the conditions established in this Contract or the inaccuracy or falsity of the data communicated via the Guarantee Annex is detected*".

In view of this, we can assume that the ICO's consent to novation/refinancing of the guaranteed obligation must be given by an equivalent mechanism (be it an express authorisation for the specific case, a mechanism for validating novations/refinancing which is enabled at the time, or a novation or addendum to the agreement itself, signed by the ICO and the relevant financial institution).

Effects of a 'homologation'

We can even give another twist to the questions we are asking about refinancing ICO COVID-19 Financing without the express consent of the ICO: in the event of refinancing that **has been homologated (court-approved) and crammed down** (Articles 599(2) and 627 of the Recast Version of the Insolvency Act ["**TRLC**"]) **on a financial institution that has granted ICO COVID-19 Financing**, would this institution retain its right of recourse against the ICO? Would those financial institutions that executed the refinancing (in which operations are refinanced with an ICO guarantee) lose their guarantee?.

In our opinion, the most reasonable take is to understand that a financial institution ("that has shown its disagreement with the arrangement") that - by virtue of homologated refinancing (scheme of arrangement) - has had its debt-claim with an ICO guarantee crammed down on, retains its right of recourse against the ICO in respect of the guaranteed amount, even if the novation/ refinancing was not consented to by the ICO. This right of recourse would only be maintained for those financial institutions that did not accept the refinancing agreement or which showed their disagreement. Those that signed the refinancing (without the consent of the ICO in respect of their guaranteed claim) would lose the right of recourse against the guarantor.

Thus, if we have, for example, ICO COVID-19 Financing for a period of three years, and this financing is refinanced with a sufficient majority to cram down on dissenting creditors, establishing a repayment schedule for a period of five years, the dissenting financial institution could sue the guarantor for the initial claim, regardless of whether or not the homologation novates this claim. In other words, without payment deferrals, without forgiveness of debt (haircuts), as it was before the refinancing. In this case, it will be the ICO, subrogated to the right of the financial institution, which will have to bear the new homologation by way of contribution, the subrogation not conferring the "outside the scope of insolvency proceedings" privilege of the claim to which it is subrogated.

However, it could also be understood that a dissenting financial institution on which a refinancing is crammed down by the special rule of syndicated financing (75% majority of Article 607 TRLC) will not have a right of recourse against the ICO since the refinancing arrangement is attached to it as if it had voted in favour even if it voted against it within the syndicate.

Assignment and subrogation in ICO COVID-19 Financing

There are of course **other issues normally linked to refinancing procedures** that can also be raised here. For instance:

- **Can ICO-backed financing be assigned?**

  In our opinion the answer is yes, although we understand that in this case it is reasonable to interpret that with an assignment the ICO guarantee would be lost, for two fundamental reasons:

  (i) only institutions that have signed the Agreement with ICO can benefit from this guarantee, whereby if the assignee has not signed the Agreement, the ICO will not be bound by this third party; and

  (ii) Even if the assignment is made to institutions that signed the Agreement, it is doubtful that the assignees can benefit from the guarantee. In each of the guarantee tranches that have been set up, the State assigned a maximum quota to each financial institution. Can this quota be altered by agreement of the institutions without the approval of the ICO and still retain the guarantee? Perhaps it is more reasonable to conceive the ICO guarantee as an *intuitu personae* guarantee, so that an assignment of ICO COVID-19 Financing without the consent of the guarantor involves a loss of the guarantee.

- **Can the ICO be crammed down on in the context of a homologated refinancing?**

  As the ICO makes payments to the financial institution that has enforced the guarantee, the ICO subrogates to the claim that the financial institution has (had) against the debtor. This is a claim of a financial nature and, therefore, susceptible of homologation. The fact that, by virtue of the enforcement of the guarantee and the subrogation, the State (through the ICO) is the new creditor does not turn it into a public administration liability for the purposes of Article 606(2) TRLC). Therefore, should be there be subsequent refinancing, this claim will be susceptible of homologation (regardless of whether the creditor is the ICO) and the ICO will have to be taken into account for the purposes of calculating majorities (only, it is our belief, if ICO has made the payment to the financial institution, and only for the amount paid, since the mere fact that it is a guarantor does not mean that it must be taken into account for the purposes of calculating majorities, since the ICO is not on the list of liabilities for the purposes of 51% of the voting if at the relevant time it still has only a 'contingent' claim by way of contribution, because "as it does not have an amount of its own", it cannot be valid for calculation purposes).

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