THE Restructuring Review

Twelfth Edition

Editor
Christopher Mallon

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THE RESTRUCTURING REVIEW

TWELFTH EDITION

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PREFACE

I am very pleased to present this twelfth edition of *The Restructuring Review*. As with the previous editions, our intention is to help general counsel, private practice lawyers and the public sector understand the conditions prevailing in the global restructuring market in 2019, and to highlight some of the more significant legal and commercial developments and trends that have been evident in recent years, and that are expected to be significant in the future.

In what appears to be a growing trend, the global economic situation, particularly for European and other Western countries, continues to be uncertain. Despite the modest strengthening of global GDP in recent years, unresolved trade tensions between the United States and China continue to unsettle markets and European countries remain in the grip of an ongoing impasse over Brexit.

According to figures published by the International Monetary Fund (IMF), global GDP growth is expected to fall from 3.6 per cent in 2018 to 3.3 per cent in 2019, with growth in the European Union falling from 2.1 per cent to 1.6 per cent over the same period. Political instability in the European Union shows no signs of abating, and remains highly visible in movements such as the '*gilet jaunes*' in France or success of populist political parties in the European Parliament elections held in May 2019. The extent of national public debt and non-performing loans in the eurozone also continue to present a major challenge to eurozone economies and the legacy of the 2008 crash is still readily apparent in countries such as Italy and Greece. Although the European Central Bank (ECB) made good on its promise to end quantitative easing by the end of 2018, interest rates in the eurozone remain at record lows and the impending departure of Mario Draghi as ECB president leaves something of a question mark over the future trajectory of European monetary policy.

More broadly, the tensions surrounding the Middle East and Russia show no indication of being resolved, and differences in global attitudes to climate change are beginning to reveal a new, and potentially very significant, source of contention between the world's major powers.

With the ever-increasing significance of the Chinese and other Asian economies on the world stage, it is also notable that the seemingly endless trend of high-paced growth appears to be slowing, with IMF figures predicting a fall in Chinese growth from 6.6 per cent in 2018 to 6.3 per cent in 2019, and a continued decline in subsequent years. Effects are bound to be felt on the global stage as the world adapts to the slowdown.

While, of course, unforeseen circumstances have a tendency to derail even the most cautious of predictions, uncertainty and financial stress are usually good indicators that a turn in the economic cycle is approaching. As such, the twelfth edition of this work continues to be relevant and important, in particular, as a result of the increasingly cross-border nature of many corporate restructurings.

As ever, I would like to extend my gratitude to the contributors from some of the world's leading law firms who have given such valuable support and cooperation in the preparation of this work, and to our publishers, without whom this work would not have been possible.

Christopher Mallon
Retired partner of Skadden, Arps, Slate, Meagher & Flom (UK) LLP
London
July 2019

Chapter 19

SPAIN

Fedra Valencia García, Íñigo de Luisa Maíz, Iñigo Rubio Lasarte and Carlos Ara Triadú[1]

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

i Liquidity and state of the financial markets

The global excess of liquidity is not an exception in the Spanish financial market. Banks and, more significantly, investors such as investment funds (opportunistic and long term), institutional investors such as pension funds and others have deployed a substantial amount of liquidity in the Spanish market.

The main focus of those investments has been real estate, either by means of direct acquisitions or through the acquisition of NPLs from the Spanish banks (with NPL transactions amounting to around €50 billion in the last 12 months), and they have also invested in industrial and telecom companies.

Banks and non-traditional lenders are also providing more short-term capital and credit lines to SMEs and consumers. This is pushing the economy significantly. In addition, the good signs and macro data of the Spanish economy brings optimism to investors, and unless political instability affects growth and confidence, it should be expected that the level of investment in Spain shall remain for all sectors in the coming years.

Questions surround the international trade war, the challenges faced by the European Union and uncertainties regarding its future, the signals of economic downturn, and the effect of an eventual interest rate rise in an economy that is much more indebted than in 2007 and 2008. However, both the banks and financial sector, and the supervising authorities are now better prepared at the national and international level to face the next financial crisis.

ii Impact of specific regional or global events

There are two measures related to the European Central Bank that may have a direct impact on the Spanish financial markets. The reduction of the ECB's TLTROs and a potential increase of the interest rates will affect a market that is still dominated by the traditional banking entities. This is helping alternative lenders take over a niche of the marketspace left that banks cannot finance because of internal limitations imposed after the last real estate crisis.

Brexit, Trump's presidency, the political crisis in Catalonia, the new Spanish and Italian governments, the euroscepticism across the EU and many other things are factors that no doubt may have an impact in capital markets sooner or later; however, it seems that money is not scared and is getting used to permanent global and political uncertainties, both at regional and global level. In Spain, for the moment and except for short periods, it is business as usual

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and companies are surfing the waves of growth and non-expensive capital. The Spanish real estate market continues its recovery. Despite this, we have not reached maximum price levels, rents are at their highest levels and we could be reaching the end of the current cycle.

iii Market trends in restructurings

For many years the Spanish Insolvency Act (SIA) proved extremely inefficient for protecting going-concern value and enabling the turnaround of economically viable companies in financial trouble. Most insolvency proceedings in Spain ended up in debtor's liquidation (which, nonetheless, permitted to maintain the going concern business through its sale to the best bidder). As a result of the 'extend and pretend' processes, normally by the time the company was entering into insolvency proceedings, it was too late for its turnaround and recovery rates for creditors were low (less than 10 per cent of the claims for unsecured creditors in most cases).

The 2014 and 2015 amendments to the SIA promoted refinancing schemes at pre-insolvency stages, introduced certain restructuring tools and new rules that provided out-of-court solutions and reshaped it into a more flexible framework. At that stage, it is revolutionary under Spanish law that dissenting creditors holding financial claims could be crammed down by a majority of creditors outside a full-blown insolvency proceeding. Since then, for instance, it was not necessary to rely on foreign jurisdictions and instruments such as the 'English scheme' to achieve successful financial out-of-court workouts of Spanish companies.

For the past years, we have seen very large and well-known Spanish companies and conglomerates (particularly, in the real estate and construction sector) involved in either pre-insolvency and out-of-court procedures or insolvency proceedings (e.g., Martinsa Fadesa, Metrovacesa, FCC, Abengoa, Grupo Isolux-Corsán, Bodybell, Celsa, Comsa, Codere, Prisa, Pescanova). During 2019 and for the next few years, we do not anticipate many distressed restructurings exceeding €1 billion. We rather expect restructuring amounts to be around €300 to €500 million owing to the large number of small- and medium-sized enterprises across Spain.

The alternative lenders and private debt funds are taking a relevant role in Spanish restructurings. In many cases, they are replacing the banks' positions and becoming catalysts of restructurings. Indeed, funds are more flexible and may grant new money and even working capital and short-term credit lines. Typically, we have seen the acquisition of the majority of the financial debt to cram down the banks and impose new terms to minority dissenters and subsequently, capitalise all or part of the financial debt or transform it into participative loans. Finally, funds are also participating in restructuring procedures by financing the acquisition of borrowers' debt at discount and once the business is sound again, they are usually replaced by traditional banks.

iv Number of formal procedures

Both creditors and debtors prefer out-of-court and pre-petition restructuring tools (individual and collective refinancing agreements, court-sanctioned refinancings (i.e., judicial homologations or 'Spanish schemes') and out-of-court payment agreements) rather than moving into formal judicial insolvency proceedings. In general, recovery rates are normally much higher at pre-insolvency stages.

The number of insolvency proceedings in 2018 stabilised at 5,700 cases. However, if we compare it with 2014 when there were almost 6,500 cases, it shows a relevant decrease, but an increase compared to 2017 (5,300). The regions of Catalunya, Madrid and Valencia still account for half of the total cases.

Since 2014, there have been a substantial number of judicial decisions of homologation of Spanish schemes. Many of these procedures have been contested and objected since the SIA did not provide a clear solution for some complex situations and, therefore, the matter was subject to interpretation. Five years later, many of these controversial issues have been resolved by Spanish courts, and the framework is now much better defined.

There is a useful public register named Registro Público Concursal (Insolvency Register), which allows anyone to check the status of any Spanish entity involved in insolvency proceedings and its judicial resolutions online (see https://www.publicidadconcursal.es/concursal-web/).

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

i Introduction to the insolvency regime

The SIA foresees a *concurso* (the full Spanish insolvency proceeding) for companies that are not able (or expect not to be able) to regularly pay their debts as they fall due. The directors of a company or the debtor must file for insolvency within two months of the date on which they became aware or should have become aware of the insolvency situation.

Unlike the US Bankruptcy Code, debtors (or creditors) do not have to make a decision between reorganisation (Chapter 11) or liquidation (Chapter 7) upon seeking judicial protection. Every insolvency proceeding begins with the 'common phase', which, however, may be coupled with other actions if debtor's filing attaches, for instance, a prearranged proposal of composition agreement or a draft liquidation plan with a binding offer to acquire the business as a going concern. The common phase starts with the judge appointing an insolvency administrator (an independent third party – creditors have no say), who will be in charge of determining debtor's estate and list of creditors (by producing the draft insolvency report). The insolvency administrator also oversees management of debtor's business (default rule in voluntary cases) or steps into the shoes of directors if so determined by the court (default rule in involuntary cases).

Creditors or any interested party may challenge the estate or the list of creditors. The common phase will not end until the court resolves these challenges, unless they represent less than 20 per cent of assets or claims, in which case the court may decide to proceed to next phase in order to reduce the length of the proceedings and preserve the value of the assets. Unless the debtor petitions liquidation, the proceeding will move onto the composition phase as a default rule (no other party can petition liquidation, except the insolvency administrator when business shuts down).

Summary insolvency proceedings may apply if the debtor: (1) has fewer than 50 creditors or its assets or liabilities do not exceed €50 million; (2) files with an early composition agreement proposal or a composition agreement with a corporate restructuring; or (3) files for insolvency with a draft liquidation plan and a binding offer.

ii Article 5 bis notice (automatic stay)

Under Spanish insolvency law, directors must file for *concurso* within two months from directors' actual or due awareness of debtor's inability to regularly pay its obligations as they come due. Failure to comply with this duty may have negative consequences for directors if they are found to have wilfully or grossly negligently created or deepened insolvency (a late petition is a rebuttable presumption thereof). Directors' liability is analysed within the frame of insolvency classification section, which kicks in if the composition agreement sets forth haircuts or term extensions of at least a third of a year or three years for all classes or in the event of liquidation. In particular, in the event of liquidation directors may be liable for the impaired claims accrued as from the onset of insolvency.

Having said that, debtors may earn an additional four-month period to keep on negotiating a refinancing agreement out of court, an out-of-court payment scheme or a prearranged composition agreement. Article 5 *bis* of the SIA establishes the proceeding to earn this safe harbour for directors. The debtor must serve notice with the court that would entertain *concurso* within two months from the onset of insolvency. The court merely acknowledges receipt (this is not an adversarial proceeding). The debtor has three months to keep on negotiating, as a *concurso* petition must otherwise follow during the fourth month. Thus, considering that the debtor has two months to file for *concurso* or serve an Article 5 *bis* notice, borrowers have at the end six months from the onset of insolvency to negotiate out of court instead of filing for *concurso*. In practice, so long as suppliers and workers are supportive or controlled, debtors may extend this period through standstill agreements (even seeking homologation thereof to bind dissidents as in the first *Abengoa* case; however, this remains highly controversial).

During this four-month period, the court shall not admit petitions for involuntary *concurso* (the debtor has preference to file voluntarily until the end of the fourth month).

Article 5 *bis* notice also establishes an automatic stay, though limited to enforcement actions (e.g., security interests, monetary judgments – not payment, setoff, etc.) over assets necessary to continue the ordinary course of business. A standstill entered into between 51 per cent of the financial claims impedes lenders to initiate enforcement actions over any assets. Yet, public claims (taxes, social security, etc.) are not affected by this automatic stay. Security interests governed by the financial collateral special regime or perfected on assets not located in Spain also escape this automatic stay (if the collateral is located outside the EU, the ability to escape the automatic stay shall rely on local insolvency law).

The debtor is allowed to file one Article 5 bis notice per year. This is consistent with the SIA's goal of promoting restructuring alternatives to *concurso*, but so long as the restructuring alternatives are actually suitable to remove financial distress.

iii Clawback actions (avoidance)

According to Article 71 SIA, debtor's acts and contracts detrimental to the estate that were performed within the two years prior to the declaration of insolvency may be avoided, even in the absence of fraud or intent. The SIA establishes certain rebuttable and non-rebuttable presumptions of detriment to the estate.

The SIA also establishes certain safe harbours, mainly: (1) acts and contracts pertaining to the ordinary course of business and at arm's length terms; (2) acts within the scope of special regulation over payment and clearing and liquidation systems for securities and hedging instruments; (3) security interests granted in favour of the salary guarantee fund

(FOGASA) or in connection with credit claims subject to public law; (4) refinancing agreements gathering specific requirements; and (5) acts or transactions subject to foreign law that are unavoidable under the circumstances.

Should the clawback action be successful, the act or contract will be rescinded Concerning bilateral contracts, parties shall then return the consideration, having the non-insolvent party right to a pre-deductible claim (or subordinated if found to have acted with bad faith). As to avoided acts and contracts other than bilateral contracts, the creditor gets a claim (e.g., regarding debt-to-asset swaps, the asset must be turned over and creditor gets a reinstated prepetition claim).

In order to avoid clawback risk, out-of-court refinancings and, in particular, the security interests taken can be 'ring-fenced' from clawback through homologation and notarisation with certain additional requirements, as explained in the next subsection below.

In addition to the insolvency law clawback action, generally applicable fraudulent conveyance actions, which require intent and have a four-year reach-back period, also work in *concurso*. Pursuant to the Spanish Supreme Court case law, intent is found to concur when a diligent creditor could not ignore that the act or contract at issue was detrimental for the estate or rest of creditors. This general fraudulent conveyance action is the only one applicable to unwind security interests subject to the financial collateral regime.

iv Formal methods to restructure companies in financial difficulties (within insolvency proceedings)

Insolvent companies have the following mechanisms available under the SIA to restructure their debts.

Composition agreements

An insolvent debtor may restructure the company's debt by entering into composition agreements with its creditors. The SIA distinguishes between two types: (1) early composition agreement; and (2) ordinary composition agreement.

Composition agreements include term extensions (up to 10 years) or haircuts (or both). They may also establish corporate restructurings such as mergers, the sale of assets or business units as a going concern (with the same rules described in Section II.ii), debt-to-asset swaps, conversion into subordinated loans (PPLs) or into any other debt instrument. Other alternatives are also available. These measures other than haircuts and term extension cannot affect public creditors. Moreover, under no circumstance can composition agreements determine the global liquidation of a company. The proposal for a composition agreement shall include a repayment schedule and a business plan (if debtor expects to repay the debt with the ordinary course cash flows).

For voting and recovery purposes, claims are classified into secured, generally privileged (unsecured but with priority in distribution), ordinary unsecured and subordinated. Secured and generally privileged claims are also classified into financial, trade, public and labour. Secured claims are stripped down in accordance with the security interest value (nine-tenths of collateral fair value). The deficiency claim is classified according to general rules.

Concerning voting, there is no cross-class cramdown or absolute priority rule (although this will chance with the implementation of the EU Preventing Restructuring Framework Directive). Spanish insolvency law relies on cram-in rules. Moreover, in spite of valuation, subordinated creditors, who have no voting rights, are entitled to the same treatment as ordinary unsecured claims (although deferred – if the composition agreement includes debt deferrals, those terms will be counted for subordinated creditors as from the expiry of the forbearance period of ordinary creditors). Finally, yet importantly, there are no equity cramdown mechanisms. The debtor can bargain with the right to petition for liquidation at any point in time (even if the composition agreement proposal comes from creditors and obtains the relevant majority thresholds). The only exception thereof are homologated refinancing agreements with an independent valuation working out the debt-to-equity swap fairness.

Composition agreements with haircuts up to 50 per cent or term extension (or conversion into PPL) up to five years require a majority of 50 per cent of ordinary unsecured claims. This is 60 per cent concerning secured and generally privileged claims. Any other content requires a 65 per cent majority threshold for ordinary unsecured creditors and 75 per cent as for secured and generally privileged creditors. A simple majority is sufficient if there is full payment within no more than three years or immediate payment with a haircut lower than 20 per cent. There is a specific voting rule established for syndicated creditors. The whole syndicate accepts the composition agreement if 75 per cent of participants favour the proposal, unless a lower majority is provided in the syndicated agreement.

Ordinary composition agreements

The debtor or creditors may submit ordinary composition agreement proposals with the support of 20 per cent per cent of the claims no later than 40 business days before the creditors' meeting. Voting may be in writing (if there are over 300 creditors) or at a creditors' meeting.

Early (pre-arranged) composition agreements

Only debtors are entitled to submit early composition agreement proposals at an early stage of the insolvency proceedings and may do so at any time from filing for insolvency, subject to certain restrictions linked to directors' failure to comply with their management duties. The debtor needs the support of 20 per cent of the claims (or 10 per cent if the proposal is filed with the petition for insolvency).

Sale of business unit (pre-pack sales)

The business unit can be sold off at any time during the insolvency proceedings with the authorisation of the insolvency administrator and court approval (usually through auctions, although direct sales are also possible). Moreover, the SIA provides a specific type of accelerated pre-packaged sale when a debtor simultaneously files for insolvency and liquidation with an agreed binding offer.

An important aspect of the sale of business units or pre-packaged sales is that purchaser can assume or reject (without having to pay damages) executory contracts, licences and administrative permits.

The purchaser can also leave behind the debtor's debts (both insolvency claims and administrative expenses) except for labour claims and social security claims. Cherry picking certain claims (normally for business reasons) is also permitted. Importantly, no taxes or tax contingencies are transferred to the purchaser. In practice, however, the deal structure becomes paramount in order to minimise the accrual of taxes related to the very sale of the business unit.

The business unit can also be transferred free of any liens and security interests (although the purchaser may elect to assume secured financial contracts, in which case the security interest is not cancelled). The statutory rule is that secured creditors who fail to enforce the security interest ahead of liquidation lose control over the collateral, although they maintain the right to get hold of a part of the price equivalent to the weight of the collateral in the estate. On the other hand, if secured creditors have already initiated enforcement proceedings and the collateral is included in the business unit, they have veto right unless (1) they receive a percentage of the price equivalent to the value of the security interest (nine-tenths of collateral fair value) or (2) 75 per cent of the secured claims from the same class (public, labour, financial or trade) so consent.

v Out-of-court mechanisms to restructure companies in financial difficulties

Out-of-court refinancing agreements

Articles 71 *bis* (1) and 71 *bis* (2) regulate, respectively, collective refinancing agreements and non-collective or individual refinancing agreements. Both refinancing agreements and their security interests enjoy immunity to any clawback action, and lenders' claims will not be equitably subordinated as for old and fresh money given as part of the refinancing.

Collective refinancing agreements are those entered into by debtor and creditors whose claims represent at least 60 per cent of debtor's liabilities (as evidenced by a certificate issued by debtor's auditor). Collective refinancing agreements must: (1) be supported by a viability plan allowing the continuity of the business activity in the short and medium term; (2) involve a significant increase of available credit, or the amendment of existing obligations (either through rollover or maturity extension); and (3) be notarised before a Spanish public notary.

Individual refinancing agreements are those available when collective refinancing agreements are not possible. These refinancing agreements shall meet the following requirements: (1) the ratio of assets over liabilities is improved; (2) the resulting amount of current assets is not less than the current liabilities; (3) the value of the security interests (calculated according to SIA criteria) does not exceed nine-tenths of the value of the outstanding debt owed to the creditors participating in the agreement, and does not exceed the previous ratio between security interests and the outstanding debt owed to such creditors; (4) the interest rate of the existing debt or debt resulting from the refinancing agreement does not exceed the interest rate applicable to the previous debt by more than a third; and (5) it is executed as a public deed before a Spanish public notary.

Half of the new money extended as part of an individual or collective refinancing agreement (homologated or not) earns the administrative expense treatment in the event of *concurso* (the other half enjoys a priority in distribution ahead of ordinary unsecured claims).

Court-sanctioned scheme of arrangement (homologation proceeding)

The fourth additional provision of the SIA regulates *homologación judicial* (court-sanctioned workouts), which is a proceeding in which a collective refinancing agreement supported by at least 51 per cent of the financial claims (excluding public, labour and trade creditors) is sanctioned or 'homologated' *ex post* by the court to protect it against insolvency clawback actions.

In addition to the protection against the insolvency clawback action and the new money incentive, the most relevant effect of the Spanish scheme is that it allows extension of effects – through a cram-in mechanism – to dissenting and holdout creditors with unsecured and secured financial claims. In this regard, secured claims that exceed the value of its collateral will be treated as unsecured claims for the non-covered portion (the deficiency claim). On the other hand, Spanish law does not foresee any mechanism to cram down equity holders. However, shareholders of the debtors may be personally liable in the event of liquidation when they reject, without a reasonable cause, a debt-to-equity proposal based on a fairness opinion that frustrates a collective refinancing or a court-sanctioned scheme. As far as we are aware, this liability regime, which presents certain technical and practical issues, has not yet been applied in practice.

The majority thresholds to extend the refinancing agreement to holdouts depend on the content and on whether such holdouts' claims are secured or unsecured.

When dealing with unsecured financial claims: (1) the majority threshold is 60 per cent of the claims to extend term extension up to five years or conversion into profit participating loans with a term up to five years; and (2) a majority threshold of 75 per cent of the claims to extend term from five to 10 years, unlimited haircuts, debt-to-equity swaps, debt-to-asset swaps, conversion into profit participating loans with a term from five to 10 years, and conversion into different financial instruments.

Regarding secured financial claims, a majority of 65 per cent of the secured claims (calculated by value of the security interest as defined by the SIA) is required as for (1) above and 80 per cent of the secured claims in relation to (2) above.

The concept of financial debt has been very controversial. According to recent cases (namely *Abengoa*), contingent debt that has not yet crystallised should not be affected debt for homologation purposes. In those cases, the only way to refinance dissident contingent debt would be a composition agreement in *concurso*.

For purposes of calculating such percentages, claims held by specially related parties to the debtor (in general, shareholders over 10 per cent or 5 per cent, directors and other entities part of the same corporate group) are not accounted. There is also a special rule for syndicated instruments, by which where more than 75 per cent of the claims support the refinancing, the whole syndicate is deemed to actually support it.

Holdout creditors may challenge the judge's homologation ruling based on two limited grounds: (1) existence of disproportionate sacrifice (a concept subject to several constructions by our courts); and (2) failure to meet the majority thresholds. The debtor can only apply for one homologation process per year, although in *Abengoa* there were two homologations (a standstill and refinancing agreement) on the basis that second one was filed by lenders, which remains controversial.

Out-of-court payment schemes

Dissenting creditors can also be crammed down by means of this straightforward mechanism only applicable to individuals and small companies (companies with less than 50 creditors, estimated liabilities or estimated assets of €5 million or less and for extension of terms up to three years). Both extensions up to 10 years and write-offs are available subject to approval by a 60 to 75 per cent majority of claims. However, debtors have not taken much advantage of it, and it has been rarely used owing to lack of creditors' support.

vi Taking and enforcement of security

Taking security

Under Spanish law, obligations can be secured by *in rem* rights (e.g., mortgages over real estate) where a specific asset secures fulfilment of an obligation, or *in personam* guarantees, where a person guarantees fulfilment of an obligation. There are also material differences in proceedings for their enforcement (as explained below) and their treatment during insolvency under the SIA where creditors with collateral over specific property or rights (e.g., mortgage or pledge), or equivalent rights (e.g., finance lease agreements) are classified as privileged creditors and are only bound by the composition if they accept it voluntarily or through cram-in mechanisms.

Real estate mortgages cover not only land and buildings built on it, but also automatically proceeds from the insurance policies related to the property, improvement works and natural accretions. Parties may also agree to extend the security interest over movable items located permanently in the mortgaged property for its exploitation, proceeds of the mortgaged property and any outstanding rent. They must be granted by means of a public deed before a public notary and filed at the relevant land registry.

Obligations can also be secured by means of a chattel mortgage. This particular type of mortgage can cover the whole business of the grantor (including leases, fixed installations, equipment, intellectual and industrial property, and raw materials and finished goods, if certain requirements are met), motor vehicles and aircraft. Industrial machinery and IP rights can also have their own separate type of security. These mortgages must be executed by means of a public deed before a public notary and entered on the chattel registry.

Since March 2016, aircraft equipment can also be subject to 'international interest' under the Cape Town Convention on International Interests in Mobile Equipment. The only requirements are to be set out in writing (identifying the object and the guaranteed obligations) and the guarantor's title to dispose of them. Entry on the International Registry of Guarantees is a requisite for enforceability against third parties. International interests have priority over any state security regulated by domestic law, even where the state security was created before, and are enforceable in insolvency proceedings if they were registered before the proceedings began (the international interest would be treated in the insolvency as a national *in rem* security).

For movable assets that cannot be the object of a chattel mortgage (because their specific identity cannot be registered), or of an ordinary pledge (given the legal or financial impossibility being transferred), Spanish law regulates the non-possessory pledge. Movable assets that may be involved in this sort of pledge are row materials and stock, and machinery. Claims not represented by securities or considered financial collateral (under the Collateral Directive and its transposition under Spanish law) can also be used in a non-possessory pledge. The law requires entry on the Chattel Registry as a condition for validly creating the pledge.

Pledges can also be granted with transfer of possession to the creditor or a designated third party. For the pledge to be enforceable against third parties, a notarised agreement or a public deed must be created. The most common type of ordinary pledge is given over shares and credit rights (such as bank accounts, receivables and insurance policies).

In Spain, a personal guarantee may be granted by means of a *fianza* (an ancillary guarantee) or by means of a *aval* or *garantía a primera demanda o a primer requerimiento* (a first-on demand independent guarantee). The aim of a first demand guarantee is to provide the beneficiary with faster and summary means of enforcement, avoiding unnecessary costs and delays derived from certain benefits and privileges conferred by Spanish law to any guarantor under an ordinary guarantee (i.e., exhaustion of remedies against debtor, division between several guarantors or main debtor and guarantor and requesting payment only after seeking first from the main debtor). In terms of enforceability of first demand guarantees, the court should not analyse the guaranteed obligation, since the first demand guarantee is an abstract, independent and autonomous obligation with respect to the loan agreement.

The most common types of security given in Spanish practice are personal guarantees and pledges over assets (i.e., shares) and claims, since they are not subject to registration (and, therefore, not subject to registration fees or taxation). Stamp duty can be triggered when granting or assigning security if granted by means of a public deed and subject to public registration.

Property mortgages are also a very usual security when the value of the property justifies the payment of the stamp duty and other related costs. More recently, floating mortgages (Article 153 *bis*) are popular since they can secure several financial obligations and, consequently, prove cost efficient, but are only available to credit institutions. Other securities also subject to registration (such as mortgages over machinery or trademarks and pledges without transfer of possession over stock or raw materials) are less common because of the stamp duty and costs involved.

Lastly, some Spanish autonomous regions, particularly, Catalonia, have approved regulation on security interests that differs significantly from Spanish common law.

Enforcing security

Under Spanish law, mortgages and pledges can be enforced in judicial or notarial proceedings. In judicial proceedings, the asset can be realised by direct sale, by a specialist entity or through an auction. Notarial proceedings can only be carried out by auction. In both proceedings, auctions must be carried out through an electronic auction held on the Official Gazette of the Spanish state's auctions portal. Pledges over credit rights are usually enforced by offsetting or direct transfer. Direct sales are still controversial, but should be fine if executed at fair value and including escrow mechanisms for junior creditors.

Personal guarantees can be enforced either through *procedimiento declarativo* (declaratory civil proceedings) or *procedimiento ejecutivo* (summary executive proceedings), the latter when certain conditions are met (granted by means of a public deed where the secured obligation is clearly specified). Summary executive proceedings are faster and more effective, while the declaratory civil proceedings are more time-consuming.

At pre-insolvency stages, the SIA limits the possibilities of enforcing collateral required for the continuity of debtor's professional or business activity. In addition to the 5 *bis* notice (see Section II.ii), upon insolvency declaration, enforcement may not commence until a composition is approved (which does not affect that entitlement) or one year elapses without composition or liquidation. For this purpose, the law extends the treatment to the recovery of movable property sold by instalments and those assigned by financial leases, as well as to the cancellation of real estate sales owing to failure on payment of the deferred price.

vii Duties of directors and liabilities; guilty insolvencies

Under Spanish law, there is no shift of directors' fiduciary duties to creditors when approaching or during insolvency. Having said that, when a company is in financial distress, directors may be found liable in certain specific cases.

Spanish companies' directors must perform their duties with the diligence of a careful entrepreneur and loyal representative. In a financially distressed scenario, that means they can be jointly and severally liable for corporate debts if they breach their duties relating to winding up the company. If losses reduce equity to less than half of share capital, directors must call a general meeting within two months to pass the resolution to wind up the company or, if the company is insolvent, to petition for insolvency proceedings.

The two-month term for calling a general meeting runs from the date the directors became aware or should have become aware of the cause for winding up with the diligence required from them. If the general meeting fails to do so, the directors have a duty to apply for a court-ordered winding up of the company.

Breaching these obligations is enough to incur directors' liability, regardless of any damage to creditors, directors' culpability or a causal link. Consequently, a creditor may claim the full amount of the debt from any director if accrued after the onset of the capital imbalance scenario.

In insolvency situations, the directors' liability regime is only triggered when it is necessary to categorise the insolvency (i.e. when the liquidation phase starts or in some cases when a composition agreement is reached) either as fortuitous or culpable. Insolvency is categorised as guilty when the insolvency situation is created or aggravated by the willful misconduct or gross negligence of the formal or de facto directors, general proxy holders or any person who had that status within the two years before the insolvency declaration.

The SIA provides for certain *iuris et de iure* (no contrary evidence is admitted) assumptions of guilty insolvency (e.g., the material breach of accounting duties) and *iuris tantum* (unless proved otherwise) assumptions of culpable insolvency (e.g., breaching the duty to timely petition insolvency declaration).

Directors in a guilty insolvency can be disqualified from managing third-party assets for a term of two to 15 years and can lose any right as creditors in the insolvency and indemnity for the damage caused. Additionally, in the event of liquidation, when the insolvency estate is insufficient to cover the claims, the court may order directors declared affected by the categorisation to cover all or part of the deficit.

III RECENT LEGAL DEVELOPMENTS

Although not constituting case law since homologation rulings are not appealable, the Seville Commercial Court No. 2 of Seville, of 25 September 2017, entails a significant court development in terms of objections and challenges to homologation.

First, in contrast to the FCC ruling, and concurring with Bodybell, the court found that syndicate dissidents (five groups of bondholders) do have standing to object to homologation. In addition, trade creditors who are aware of their claims being affected by the restructuring also have standing to object to homologation based on the commercial character of their claims (the *Eroski* case had particularly cast doubt on this). Otherwise, commercial creditors may eventually seek relief before general jurisdiction courts.

Second, in contrast to the FCC criterion, the judge sustained that the majorities must be determined as per the total financial debt and not as far as the affected debt only. The 75 per cent threshold calculation base includes: (1) financial claims outside the refinancing debt scope; (2) non-compromised debt, such as interim new money financing; and (3) secured debt, irrespective of whether or not the effects are extended to dissident secured claims – which may be analysed under the disproportionate sacrifice exception.

Third, the court confirmed that contingent claims are not financial claims for homologation purposes. Contingency disappears with technical default occurrence. Whether financial statements are correctly elaborated (and whether or not a guarantee was registered as a liability, a provision, or not even accounted for in the balance sheet) is not a critical argument to consider that a liability is or is not a financial claim, despite the consequences of any potential flaws as a matter of corporate law and, potentially, directors' liability. This criterion has recently been controverted in other courts.

Fourth, the court concluded that the arguments below may be embedded within the disproportionate sacrifice exception (which permits dissidents to be left off the hook, but does not entail the workout unwinding unless to specifically provided in the refinancing agreement):

a the sacrifice is unnecessary because (1) the restructuring is unfeasible – on the other hand, holdouts cannot object to homologation based on the absence of a business plan or seek unwinding thereof based on plan unfeasibility; or (2) the workout content exceeds the real needs under the business plan; and

b the sacrifice is unfair: (1) in light of the liquidation test; (2) because the dissident is treated less favourably than acceded creditors without sufficient reason or consideration; (3) because holdout receives worse treatment than other creditors with the same priority in distribution in bankruptcy; (4) because creditors who would be junior in bankruptcy are treated equally or better than holdout; or (5) because the better treatment obtained by senior creditors is unreasonable in light of the difference as to the bankruptcy priorities in distribution.

Fifth, the court sustained the existence of disproportionate sacrifice based on different treatment conferred to supporting and dissident lenders in terms of haircuts, term extensions and interests. Holdouts should have given the option to choose after homologation, similar to the acceded lenders.

Certain other relevant points in this ruling are the following:

a As for the allegation that the security interests in favour of the new money were disproportionate, the court found that this is not a valid ground to object to homologation. Besides, the homologation ring-fence protection does not impede challenges based on generally applicable fraudulent conveyance law.

b The court also rejected the absolute priority rule allegation, because (1) Spanish insolvency law only establishes two classes as per homologation: secured and unsecured financial claims; and (2) apart from the fact that the draft EU Directive absolute priority rule is not yet in force, it could not be applicable in homologation, since, strictly speaking, no class is imposing a plan over other dissident classes.

c The court held that (non-enforced) bonding lines, corporate guarantees and insurance are financial claims, despite the underlying obligation being a commercial or trade claim. On the other hand, enforcement leads to the settling guarantor or insurer stepping in the shoes of the trade creditor. Hence enforced corporate guarantees, insurance and bonding lines would not be financial claims and would, therefore, be unaffected by homologation.

d The court sustained that the public claims safe harbour is only applicable to European administrations and agencies.

e Irrespective of whether the workout is extended to dissident holders of secured claims, the court insisted on its view that the petitioner must produce the security interests valuation report. The court rejected Abengoa's and supporting lenders' allegation that this was not required as, following the enforcement of the security interest, the deficiency claim would have always been subject to the alternative restructuring terms (i.e., to the refinancing agreement).

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

The crisis in Spain has affected severely all sectors. However, the construction companies, real estate developers, retailers, manufacturers and some financial institutions are the ones that suffered from this the most. Even at this economic stage, Abengoa and Toys 'R' Us are both good examples.

i Toys 'R' Us Iberia: sale and new facility

As a result of the Toys 'R' Us group's financial troubles worldwide, its companies in Iberia took joint and several liability for global liabilities worth almost US$900 million. In addition, due to the insolvency of several of the group's companies and the risk of enforcement of the security against the assets in Spain, the group filed for bankruptcy for three of its Spanish companies in March and April 2018: the two shareholding companies of the company operating in Spain and the company owning the real estate. The restructuring solution consisted of an agreement with the main creditors, allowing an investor to step in with sufficient resources to ensure the group's future viability in Spain and Portugal.

The transaction was authorised by Commercial Court No. 7 of Madrid in an order issued on 26 July 2018, which considered the interest of all the group's companies – not just the interest of the company that provided the security in the transaction – and analysed the transaction's countervailing benefits (reduction of liabilities, business continuity, overcoming insolvency) as opposed to an alternative scenario (bankruptcy of the whole group in Spain and Portugal).

The procedure ended in August 2018 with the (1) execution of a sale agreement for the shares of the group's parent company in Iberia by Portuguese investment group Green Swan, and (2) granting a facility of €59 million by Incus Capital. Thanks to this financing, Toys 'R' Us has managed to cancel all its debt with international creditors, to overcome insolvency and to obtain funds to finance the continuity of its activity in the Iberian market.

ii Abengoa: 2019 restructuring

The 2019 restructuring process of Abengoa's group has been one of the Spanish largest restructuring in 2019 (with a debt of approximately €3 billion) and had worldwide impact, due to the size and international presence of the group. The restructuring process began on September 2018, when the company and its financial creditors set out the main terms and conditions for the refinancing of its debt and continued in December 2018, when the debtor and its financial creditors entered into a lock-up agreement. The restructuring process was completed with the execution of the restructuring agreement in March 2019 and the subsequent effectiveness of the restructuring documents taking place in April 2019.

The restructuring agreement of the engineering and renewable energy group resulted in, among others, (1) a €97 million new money injection arising from the issuance of convertible bonds by A3T LuxCo 2; (2) a €140 million injection in favour of Abenewco 1 by means of a new syndicated guarantee line and the amendment of the terms of the 2017 existing syndicated guarantee line; (3) the restructuring of the NM2 debt, including a partial debt assumption by A3T Luxco 2 of the 45 per cent NM2 debt that was sitting in Abenewco 1; (4) the recognition by Abenewco 1 in favour of certain financial creditors, of a restructuring commission by means of a new reinstated debt facility agreement; (5) the recognition by Abenewco 1 in favour of certain financial creditors, of a restructuring commission by means of the issuance of mandatory convertible bonds, for a nominal of approximately €5 million, which would entitle them upon conversion to 22.5 per cent of Abenewco 1's share capital; (6) the restructuring of the restructuring of the old debt (that accrued or that stemmed from contracts entered into prior to the first restructuring); and (7) the amendment of the 2017 intercreditor agreement and security package.

On May 2019, Abengoa filed for the homologation of the 2019 restructuring agreement. The 100 per cent of the financial debt adhered to the 2019 restructuring agreement and therefore, no dissenting creditors need to be crammed down.

V INTERNATIONAL

The new European Regulation on insolvency proceedings (EU Regulation 2015/848, recasting EU Regulation 1346/2000) entered into force on 26 May 2017. One of the goals of EU Regulation 2015/848 is the inclusion in Annex A of all new restructuring proceedings (alternative to full-blown insolvency proceedings) enacted across the EU. In the case of Spain, Article 5 *bis* notices, homologation and out-of-court payment schemes are now automatically recognised in the EU.

Concerning reorganisation of companies with their COMI in Spain and multi-jurisdictional debt instruments, we expect homologation to remain the restructuring means chosen to deal with these cross-border cases. Homologation passed muster for the Chapter 15 recognition test in both the *Abengoa* and *Isolux* cases. Most importantly, absent a COMI-shift, other alternatives (such as Chapter 11 and scheme of arrangements) present significant issues when it comes to cramming down dissenters with recourse to assets located in Spain. First, Spanish courts shall not recognise foreign main proceedings where the jurisdiction is not based on COMI location or similar criterion. Second, any creditor would always be entitled to seek a non-main proceeding in Spain, undermining the benefits of a global and comprehensive reorganisation. Third, in the absence of a non-main insolvency proceeding in Spain, secured creditors with collateral located in Spain would be able to bypass the main insolvency proceeding automatic stay and be instead subject to the Spanish insolvency law automatic stay.

Finally, yet importantly, concerning clawback risk, Spanish courts shall provide protection to creditors, purchasers and other third parties under contracts subject to non-Spanish law, according to which the contract or act at hand would be unavoidable under the circumstances (see, recently, the ruling from Palma de Mallorca Court of Appeals of 17 October 2017 – *Orizonia* case). Within the EU territory, the ECJ ruling of 8 June 2017 (*Vinyls Italia SpA*, C-54/16) has confirmed the ability of the parties to have a contract governed by foreign law even where all the links are tied to the same country (Italy), absent fraud, which must be determined by the insolvency court.

VI FUTURE DEVELOPMENTS

Although no comprehensive insolvency law reform is currently pending, we expect reforms revising the current structure and drafting (proposal presented by a group of experts on 6 March 2017), without meaningful changes, and reinforcing the role of the homologation proceeding based on Directive on preventative restructuring frameworks, 'second chance' and measures to increase the efficiency of restructuring, insolvency and discharge procedures.

Appendix 1

ABOUT THE AUTHORS

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Cuatrecasas

Fedra Valencia is a partner at Cuatrecasas and a renowned specialist in the legal management of bankruptcy proceedings and legal advice on corporate and financial restructuring transactions. She has participated in several bankruptcy proceedings, including some of the most relevant on a national scale, defending the interests of both debtors and creditors, as well as in debt-refinancing transactions (both in and out of court) and corporate-restructuring agreements, which were beneficial for her clients with respect to their creditors. She is also an expert in administrative liability.

Throughout her professional career, she has advised and represented various debtors in the preparation, presentation and follow-up of bankruptcy proceedings, including many companies in the real estate and industrial sectors, as well as participating in agreement proposals and ad hoc processes arising from the aforementioned proceedings, both ordinary and reintegration.

She has also represented the interests of creditors, providing advice to financial institutions and companies in corporate bankruptcy proceedings for a wide variety of sectors, including the air transport, automobile, construction and energy sectors.

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Mr de Luisa is a partner at the Cuatrecasas Madrid office. Since 1996, he has specialised in banking and financing transactions, particularly those with international exposure. He has ample experience in leveraged and acquisition finance, corporate finance, project finance and direct lending, etc. His sector expertise covers a wide range of asset classes, with a strong focus on real estate, energy (renewables) and infrastructure.

He has also advised on complex debt restructuring and refinancing deals at pre-insolvency stages (including the Spanish schemes and judicial homologation cases) and participated in several transactions advising international investors in the acquisition of distressed debt and non-performing loans portfolios (both secured and unsecured). He was directly involved in the incorporation of the Spanish bad bank (Sareb) and its transfer of impaired assets (€51 billion). More recently, he has regularly participated in bidding processes of loan portfolios on the buyer's side and debt-for-equity and debt-for-assets situations.

From 1999 to 2000, he was an international associate in the banking group of Simpson Thacher & Bartlett in New York. From 2006 to 2008, he was based at Cuatrecasas' London office, where he was responsible for the finance practice.

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Mr Rubio is a partner who specialises in advising on the financing of infrastructure projects (public private partnerships and private finance initiatives) and real estate projects, whether simple, syndicated or structured (e.g., sale-and-leaseback and off-balance-sheet transactions).

He also has ample experience in corporate and asset finance, and debt restructuring transactions, having participated in several of the most important and complex refinancing processes of recent years. Recently, Mr Rubio has been involved in advising institutional investors in their acquisition of NPL portfolios from the Spanish financial entities. Since joining Cuatrecasas, Gonçalves Pereira in 2000, Mr Rubio has developed most of his career in the firm's offices in Madrid and then London, where he was managing partner between 2010 and 2013.

Recommended by several directories, including *Chambers Europe*, *Chambers Global*, *Best Lawyers* and *The Legal 500* in real estate and corporate and M&A, banking and finance, project finance (Spain and the UK) and public finance.

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A senior associate in the litigation practice and qualified to practise in Spain and in the state of New York, Mr Ara specialises in cross-border restructuring and insolvency (both out-of-court workouts and judicial proceedings). He is an expert in European and Spanish insolvency law, with extensive experience in advising lenders, debtors, directors and bidders in high-profile cases across almost all industries.

He regularly collaborates on structuring transactions to address potential litigation and insolvency issues. Recent work includes loan-to-own transactions and cross-border rescue financings, to tackle new money privileges, as well as clawback and automatic stay risks.

As a litigator, Mr Ara also has experience in security interests, directors' fiduciary duties and corporate and M&A-related dispute

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