

Rescue Financing Alternatives in Spain

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1. Introduction

Given the situation of Spanish market generally—and the latest reforms on restructuring of the financial sector more particularly— it seems that cash flow shortage may be ongoing in the near to mid term future for some Spanish corporations. Upon this situation stressed or distressed companies may consider rescue financing alternatives in substitution—or in addition to— other traditional funding. Generally within a broadest restructuring deal, non-bank lenders may have an interesting role to play in providing for liquidity facilities.

We have tried to set out below the main provisions of the Spanish Insolvency Act ("**SIA**") which may affect the provision of fresh money to companies in stress ("**Rescue Financing**") updated with the novelties introduced by the reform passed towards the end of last year. This document does not pretend to be comprehensive and should not be relied upon.

The implications and effects of the SIA's regulations on Rescue Financing shall basically depend on the scenario in which the Rescue Financing occurs.

2. Rescue Financing prior to commencement of insolvency proceedings

Prior to the commencement of any insolvency proceedings a debtor may seek Rescue Financing—and a lender may grant the same— without any particular formalities or requirements based on the SIA. However, if such Rescue Financing is granted within a refinancing agreement

(as defined in the SIA and described below, a "**Refinancing Agreement**") the situation for the rescue financier may improve significantly as regards two major issues: clawback and ranking.

2.1. Rescue Financing outside a Refinancing Agreement

(a) *Clawback*: financing can be implemented but clawback risks need to be analyzed in detail. Upon insolvency of the debtor any such Rescue Financing—as well as any security attached to it— may be subject to rescission if: (i) granted within the two-year hardening period set out under the provisions of the SIA, and (ii) considered detrimental to the insolvent estate—and regardless of whether those acts had been performed with the aim of deceiving the interests of the creditor or not—. Is the granting of new financing detrimental to the estate? There are several questions that need to be answered here, among others: (i) has the new financing artificially extended an obsolete business worsening the chances of recovery of other creditors?, (ii) has the new financing provided any benefit to the stakeholders of the company as a whole? (iii) has the new financing been used to repay existing creditors thus the total liabilities of the company being equivalent—and maybe taking security out of the *pari passu* treatment—? Also importantly, under the SIA new securities granted for old money—or for new money refinancing

old money— and prepayments of non-matured obligations are presumed to be detrimental —thus rescindable—. Conclusion is that, although Rescue Financing alternatives without a Refinancing Agreement are available, the risk of the financing, its security, or the payments made with the new cash being rescinded cannot be ruled out.

- (b) *Ranking*: being a rescue financier will not provide in this scenario any benefit on ranking against other creditors of the debtor. In most cases the debt would rank secured (if security with sufficient value is granted and not subject to clawback) or ordinary (if no security is granted). There are obviously different situations as, for example, when the financing is provided by shareholders or directors.

2.2. Rescue Financing within a Refinancing Agreement

- (a) *Clawback*: claw back risk can be mitigated if the Rescue Financing agreement is granted within a broader Refinancing Agreement that meets the requirements established in Section 71.6 of the SIA: (i) the purpose of the refinancing agreement shall be to substantially increase the funds available to the debtor; and/or to amend the terms of the debt that is to be re-negotiated by means of the Refinancing Agreement; (ii) the Refinancing Agreement shall be a part of a short and mid term viability plan of the debtor; (iii) the Refinancing Agreement shall be approved by creditors representing, at least, 3/5 of the liabilities of the debtor; and (iv) an independent expert appointed by the Companies Registry should issue a report assessing on, among other issues, sufficiency of the information provided, reasonability of the Refinancing Agreement, proportionality of its security and sensibility of the viability plan. The Refinancing Agreement shall also be executed before a Spanish Notary Public and recorded in a public deed to which all documents evidencing the content of the Refinancing Agreement

as well as the fulfillment of all the above-mentioned requirements shall have to be attached. If the above are complied with and the Rescue Financing is included within a broader Refinancing Agreement the clawback risk of the financing or its security is severally mitigated.

- (b) *Ranking*: with the latest reform of the SIA some incentives for lenders willing to carry out rescue financings have been introduced. In particular Section 84.2.11^o of the SIA provides that any credits representing income for the debtor obtained within a Refinancing Agreement as set out under Section 71.6 shall be deemed 50% credit against the estate or pre-deductible —i.e. super senior as regards the unsecured claims— and 50% privileged —senior to ordinary claims and junior to pre-deductible claims, in both cases as regards the unsecured claims—. For the avoidance of doubt this will not apply if the fresh money is obtained from the debtor itself, its shareholders or persons specially related to the debtor.

3. Rescue Financing provided after the commencement of insolvency proceedings

Rescue Financing can also be provided once a company has filed for insolvency. Once insolvency proceedings have been initiated the Court shall determine the management powers and authorities over the debtor. As established in Section 40 of the SIA, If the insolvency proceeding is “voluntary” (initiated by the debtor itself) the debtor shall keep the managing and disposal faculties although these shall be subject to the intervention of the Insolvency Administrators by means of approval or consent. If the insolvency proceeding is “compulsory” (initiated by the creditors), the Insolvency Administrators appointed by the Court shall directly hold the managing and disposal faculties over the assets of the insolvent debtor. Accordingly, after the initiation of insolvency proceedings approval by the Insolvency Administrators shall be required for any Rescue Financing being implemented.

- (a) *Clawback*: if the Rescue Financing is granted within an insolvency process

clawback risks are fundamentally inapplicable.

(b) *Ranking*: according to Section 84 of the SIA payments resulting from

contracts validly entered by the debtor after insolvency will be credits against the estate or pre-deductible —i.e. super senior as regards the unsecured claims—.

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