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OVERVIEW OF RECENT DEVELOPMENTS INTRODUCED BY RDL 11/2014, 5 SEPTEMBER, ON URGENT MEASURES CONCERNING INSOLVENCY LAW

On 6 September 2014, the Royal Decree Law 11/2014 of 5 September, by means of which certain urgent matters concerning insolvency law were adopted (hereinafter "**RDL 11/2014**") was published in the Official State Gazette ("*BOE*"). Such RDL 11/2014 entered into force the following day to its publication. However, the final text is still pending to be confirmed by the Parliament.

The RDL 11/2014 extends the recent amendments, already implemented on pre-insolvency arrangements by RDL 4/2014 of 7 March on urgent matters on business debt refinancing and restructuring (hereinafter, the "**RDL 4/2014**"), to insolvency proceedings. After receiving the Government's confirmation, the draft of the RDL 4/2014 was submitted to the Parliament's approval and processed by the urgent procedure. As of today, such procedure has not been completed yet.

The fact that the RDL 11/2014 has included most of the provisions already set out for the pre-insolvency stage in RDL 4/2014 suggests that once the parliamentary procedure in respect to such decree is over, the RDL 11/2014 will be subject to further amendments in order to harmonize both texts.

Additionally, it introduces other important amendments to Law 22/2003, 9 July on Insolvency (hereinafter, the "**Insolvency Act**" or "**SIA**"), as well as in other related matters.

The main amendments introduced by RDL 11/2014 are the following, which will be explained in further detail throughout the different sections of this alert:

- Certain changes in the credit raking, which will limit the value of secured claims and will also expand subordination.
- A total change in the majorities required to reach a composition agreement and the possibility to offer certain other alternatives to a writte-off or extension.
- Possibility to cram-down secured creditors not accepting the composition agreement.
- A comprehensive regulation of the transfer of a business unit.

1. AMENDMENTS REGARDING THE RANKING OF CLAIMS:

1.1. New limits to special privileges:

Broadly speaking, the SIA distinguishes among the following creditor classes for the purposes of insolvency proceedings:

(i) Specially privileged creditors. This category of creditors comprises secured creditors and financial lessors (which for many purposes are treated as secured creditors in Spain). These types of creditors are only awarded a preferred ranking on the proceeds of the sale or enforcement of the asset affected by their security.

(ii) Generally privileged creditors. This category comprises a variety of creditors, such as workers or public entities (social security, tax). They hold a preferred ranking over all assets of the insolvent debtor, but rank below specially privileged.

(iii) Ordinary creditors. Those who are neither preferred in ranking to any other class, nor subordinated. Generally, the vast majority of creditors comprised in this class shall be trade creditors.

(iv) Subordinated creditors. Those who rank below ordinary creditors. Pursuant to the SIA, interest accrued by any non-secured loan and those credit rights held by a specially related party to the debtor (such as a shareholder loan) are considered subordinated.

Along with these four types of creditors, the SIA also provides that certain credit rights, mostly originated through the insolvency proceedings, will be deductible from the insolvency estate. In practical terms, this means that such credits (generally referred to as credits against the insolvency estate or "*creditos contra la masa*") are awarded a rank between (i) and (ii), and are paid at maturity, rather than at the moments where payment is generally performed in the course of insolvency proceedings.

Until the entry into force of RDL 11/2014, a specially privileged creditor had a preferential right over the amount obtained from enforcing the security attached to the secured asset. If the amount obtained was not sufficient to cover the secured amount, such remaining amount was then re-qualified according to its nature (most commonly considered as an ordinary credit).

The SIA, however, did not provide for any rule to determine which part of the credit should be considered unsecured and which one secured. The RDL 11/2014 has extended to insolvency proceedings a valuation system already implemented in pre-insolvency scenarios by RDL 4/2014, which enables the calculation of the value that may be allocated to each piece of security attached to a particular asset, also in insolvency proceedings. Hence, each privileged creditor will only be considered as such to the extent that the fair value of the secured asset is sufficient to cover his debt. Therefore, the amount of the debt exceeding the fair value of the asset will be qualified according to its nature (most commonly an ordinary credit).

The determination of the security's value becomes crucial with the RDL 14/2014, not only because the rights of a secured creditor are reduced, but also because the valuation is taken into account at other different stages of the insolvency proceedings, such as the determination of the necessary majorities to cram down dissenting creditors to a composition agreement, or to give their consent to certain disposals of secured assets in the liquidation stage.

Simply explained, in order to calculate the portion of the credit of a particular secured creditor that will be considered secured or privileged, the next steps shall be followed:

1º The fair value of the asset shall be calculated and then reduced by 10%. For these purposes, **fair value** means:

- For **real state and immovable property**, the value determined by a report submitted by a Valuation Company officially recognised by the Bank of Spain.

- For **securities that are officially listed on a stock exchange or other regulated market, or money-market instruments**: the weighted average price of such securities within three months before starting the insolvency proceedings.

- For **other assets**: the value determined by the report issued by an independent expert, in accordance with the principles and rules generally applicable to determine the value of this kind of assets.

  In the event of cash, bank accounts, electronic money or fixed-term deposits, such report will not be required. Be advised that a monetary claim against a debtor is not considered cash under Spanish law, but a credit right which is not exempt from valuation.

2º Once the fair value of the asset is established, any preferential liens or encumbrances to that of the security whose value is being calculated shall be deducted from the fair value. This result shall be the basis for calculating the value of the security (for the purposes of this explanation, this value shall be referred to as the "**Reference Value**"). We can then have three different scenarios:

- The Reference Value is **negative result or equal to 0**: the value of the security is 0 and, therefore, the creditor does not enjoy any privilege over the asset. All his credit is considered unsecured as other preferential liens or encumbrances to the one he benefits from cover the whole fair amount.

- A **positive result but lower than the amount of the privileged credit**: in such case, the value of the security is the Reference Value. The creditor shall be considered a secured creditor up to the amount of the Reference Value and unsecured (normally ordinary) for the remaining portion of its credit. The same rule applies in the event that the piece of security contains a maximum secured amount lower than the total outstanding amount of the credit right[1].

- A **positive Reference Value which is also higher than the secured obligation**. In this case, the creditor shall be deemed secured for the total of its credit, and there is additional headroom for other creditors who rank below him to be paid out of hte proceeds of the relevant asset.

Additionally, the law provides for special rules in the event of shared security (which typically occurrs in the case of syndicated loans and for the cases where various assets secure the same debt):

- In the case of shared security, the benefit of such security will be allocated to the sharing beneficiaries, pursuant to the terms established in the agreement governing the security share.

- In the case of several assets securing a single debt, the total value of the security shall be capped at the outstanding debt. No rule is provided to determine how the security value shall be allocated among the different assets.

Should there be a significant alteration in the valuations, a new report from an independent expert shall be provided. It is most likely that this situation occurs frequently, bearing in mind that the

[1] This may occur in mortgage loans in which the principal amount owed together with its interests, is higher than the maximum secured amount by the mortgage: if the debt is 10 million and the mortgage secures only 5, the maximum value of the security may not exceed the latter value, even when the value of the secured asset and the secured obligation are higher, as the mortgage will only be securing 5 million against third parties.

length of the insolvency proceedings – usually multiannual – will cause significant alterations on the value of certain assets, such as real estate.

1.2. Extension of the concept of specially related person.

The condition of specially related persons has been extended to cover the cases listed below. It should be noted that the SIA provides that being considered a specially related person causes the subordination of the credit right held by the related person vis-a-vis the insolvent debtor, even if such credit is secured.

For **insolvent individuals**:

- The companies controlled by the debtor, or by any of the individuals that were already considered specially related (spouse, ascendants, descendants, etc), or *de iure* or *de facto* directors. For these purposes, control has the meaning provided in art. 42.1 of the Commercial Code[2].

- The companies within the same group as the companies abovementioned.

- The companies in which the individuals abovementioned are *de iure* or *de facto* directors.

For **insolvent companies**: If the shareholders are individuals, those persons specially related to the shareholders will also be considered specially related persons to the company.

As a result of the above amendments, the list of specialy related persons to any company is as follows:

(i) The shareholders, who are personally liable for the corporate debts and those creditors who hold, either directly or indirectly, a stake of 5 per cent of the share capital, if the insolvent company is a listed company or a stake of 10 per cent of the share capital, if the insolvent company is a non-listed company. In addition, if the aforementioned shareholders are natural persons:

- The companies controlled by the debtor, or by any of the individuals that were already considered specially related (spouse, ascendants, descendants, etc) or *de iure* or *de facto* directors. For these purposes, control has the meaning provided in art. 42.1 of the Commercial Code.

- The companies within the same group as the companies abovementioned.

- The companies in which the individuals abovementioned are *de iure* or *de facto* directors.

(ii) The *de iure* or *de facto* directors of the insolvent company, its liquidators and its general attorneys, as well as those persons who have held these positions during the two years previous to the declaration of insolvency. Creditors who have executed a re-financing agreement pursuant to the provisions of article 71 bis, or to the fourth additional disposition of the SIA, will be considered as *de facto* directors for the obligations undertaken by the insolvent debtor in relation to the viability plan.

(iii) The companies belonging to the insolvent debtor's group and their common shareholders, if they meet the requirements set out in section (i).

[2] Broadly speaking, under art. 42.1 of the Commercial Code, a company is deemed to control another when it owns the majority of its share capital, or voting rights or may appoint the majority of its directors.

1.3. Inclusion of new classes of creditors.

Article 94 of the SIA introduces **new classes** in which privileged creditors will be divided:

- **Employment claims**: which includes any employment creditors. For employees with Senior Management employment relationship, their claim will only be included in this category when it does not exceed the amount already considered with general privilege under article 91.1 of the SIA (broadly speaking: it is only included the triple of the minimum wage, not the real salary that will commonly be much higher).

- **Public law creditors**: it includes any public law creditors (such as tax authorities or social security and those held by a relatively big number of institutions).

- **Financial creditors**: comprises any holder of any financial debt whatsoever, regardless of being or not subject to financial supervision.

- **Other creditors**: among which commercial creditors and other creditors for commercial transactions, not included in the above categories, are included.

This classification does not vary the privilege of the creditors concerned, nor does it alter the ranking of their credits in the SIA. It is primaily aimed at **the necessary majorities to approve a composition agreement and cram-down dissenting creditors within the above clases**. This is a major innovation in contrast with the former regulation, in which privileged creditors could not be obliged to accept a composition agreement**.**

The SIA does not provide any cross-class cram-down. Furthermore, non-secured creditors may not cram down secured creditors even whithin their own class.

2. AMENDMENTS RELATING TO COMPOSITION AGREEMENTS:

2.1. Introduction of new contents of the composition agreements:

(i) The new regulation introduces the **possibility of including** in the composition proposal various **alternative options**[3] not provided in the former regulation, for all or some of the creditors, except for public law:

- **Exchanges of debt to convertible bonds**, subordinated claims, loans with capitalised interest or any other financial instrument with ranking, term or conditions different from the original debt; or

- **Debt to equity swaps**. In this regard, the required share capital increase of the debtor, so as to capitalize the claims, shall be subscribed by the majority of votes duly issued, for private limited companies (S.L.), or by an ordinary majority of the shareholders attending the meeting or duly represented, in the event of a public company (S.A.).

Conversely to what is established in the RDL 4/2014, the SIA has not included a mechanism whereby uncooperative shareholders could be forced to accept a capitalization.

(ii) It is expressly set forth that composition agreements may include, within its content, **sale proposals of all the debtor's assets or of its productive units**. In such case, the acquirer shall undertake to continue with the business activity.

[3] The SIA refers to these contents as "alternative proposals". In our view, the fact that these are considered alternative means that the composition agreement will need to give the creditors the possibility to choose between the following options: one not containing any of these innovative provisions; and one (or more) containing any of these new possibilities.

(iii) The composition agreement may also include **assignments of assets *in lieu* of total or partial payment**, but only if such assets are not necessary for continuing with the professional or business activity of the debtor. If the fair value of the asset is higher than the debt, the remaining amount will join the estate of the insolvent debtor.

Conversions into participating loans or any other measures provided in paragraph (i) may not be imposed neither to employment creditors, nor to public law creditors, and the assignment of assets on payment or for payment may not be imposed to public law creditors.

2.2. New majorities to pass the composition agreement.

The majorities required to pass a composition agreement and the write-off and stay limits that could be included in the composition agreement have been completely amended. In addition, if certain majorities are reached within the same class, the composition agreement may affect to secured creditors. This novelty is historic in Spanish Insolvency Law.

(i) The composition agreement requires the favourable vote of the **ordinary creditors** representing, at least:

a) A **higher number of votes in favour than against the proposal**, if it provides one of the following alternatives:

- The full payment of ordinary credits in less than 3 years; or
- The immediate payment of the ordinary due credits, with a write-off of less than 20% of the credit.

b) **50 per cent** of the company's liabilities to adopt the following measures, set out by the new article 124.1 a) of the SIA:

- Write-offs of 50 per cent or less the amount of the credit;
- Stays (of principal, interests or any other outstanding amounts) of up to 5 years;
- Debt-conversion into participating loans during the same term.

c) **65 per cent** of the company's liabilities to adopt the following measures, set out by the new article 124.1 b) of the SIA:

- Write-offs exceeding 50 per cent the amount of the credit;
- Stays (of principal, interests or any other outstanding amounts) between 5 and 10 years; or
- Debt-conversion into participating loans during the same term, and the rest of the measures explained in section 2.1.

(ii) In case of syndicated credits or loans, a majority **representing 75 per cent of the liabilities affected by the agreement, (or any lower majority set out in such agreement)**, will be enough to consider that all the syndicate votes for the agreement, including the non participant of dissident members.

(iii) In addition, in order to bind **privileged creditors** by the agreement, the following majorities, to be reached among their classes, are required:

a) **60 per cent**, in order to implement the following measures:

- Write-offs of 50 per cent or less the amount of the credit;
- Stays (of principal, interests or any other outstanding amounts) of up to 5 years;

- Debt-conversion into participating loans during the same term (in case of creditors which are not included between the public and labour ones).

b) **75 per cent**, in order to implement the following measures:

- Write-offs exceeding 50 per cent the amount of the credit;
- Stays (of principal, interests or any other outstanding amounts) between 5 and 10 years; or
- Debt-conversion into participating loans during the same term, (in case of creditors which are not included between the public and labour ones).

The **calculation of such majorities** will be carried out:

a) In case of **specially privileged creditors**, according to the proportion between the accepting securities out of the total value of the securities granted among each class.

b) In case of **generally privileged creditors**, according to the proportion between the accepting liabilities out of the total liabilities which are benefited by the general security among each class.

As regards to the possibility of binding specially secured creditors set out under the RDL 11/2014, some **precisions** must be made:

a) As the majority is determined in relation to each class, and the public creditors are not considered to be one of them, it is **impossible to bind public creditors without their consent**.

b) The new **classes** referred to in section 1.3 above, can gather generally and specially privileged creditors, as they **are established according to the type of creditor, not according to the type of security**. The RDL 11/2014 seems to require that, in case there are specially and generally secured creditors within a same class, both types of creditors shall reach the required majorities separately.

2.3. Rules set out in order to modify a composition agreement in case of breach.

Until the RDL 11/2014 came into force, creditors may apply for the resolution of the composition agreement and the opening of the liquidation stage in case of breach. The RDL 11/2014 has established a proceeding by which creditors may apply for the amendment of a composition agreement approved in accordance with the previous legislation, but only within two years from its entry into force. The **requirements** are the following:

(i) In order to **apply for an amendment**, a **majority of at least 30 per cent of the total liabilities** at the time of the breach is required.

(ii) In order to **pass the amendment proposal** of the composition agreement, the favourable vote of the creditors representing the following majorities of liabilities is required:

a) In case of **ordinary creditors**:

- **60 per cent**, in order to implement measures provided in section (i) b) above.

- **75 per cent**, in order to implement measures provided in section (i) c) above.

b) In case of **secured creditors, except the public creditors, the following majorities** (as in the aforementioned case, to be reached among each class):

- **65 per cent**, in order to implement measures provided in section (iii) a) above.

- **80 per cent**, in order to implement measures provided in section (iii) b) above.

2.4. Elimination of the rule which prevented those creditors who had acquired their credits after the declaration of insolvency from voting.

The **right to vote** has been recognized to creditors who had **acquired their credits after the declaration of insolvency**. Such reform may boost the secondary market of distressed debt. It will also be beneficial for holders of debt securities.

2.5. Amendment of the provisions regarding the opening of the qualification statement section of the insolvency proceedings ("*pieza de calificación*").

The qualification statement section of the insolvency proceedings (which may lead to directors liability for the debts of an insolvent company) will not be opened if the composition agreement establishes for all creditors, or for all creditors included in one or more of the classes mentioned in section 1.3, either: (i) a write-off below one third the amount of their credits; or (ii) a stay of less than 3 years.

3. AMENDMENTS RELATED TO THE TRANSFER OF PRODUCTION UNITS:

The reforms introduced by the RDL 11/2014 are primarily aimed at safeguarding the continuity of the business activity of the insolvent debtor. In order to achieve this aim, some innovations are introduced for the transfer of production units, such as:

(i) The **automatic subrogation** of the acquirer in:

- The **contracts** affected to the business activity of the debtor, whose termination has not been applied for, even without the consent of the counterparty.

- The **licenses and administrative authorizations** attached to the continuity of the business activity, as long as the acquirer continues to carry out the activity in the same premises and has not expressly declared its intention of not subrogating himself in such licenses or administrative authorizations. Subrogation cannot exclude the workers rights in case of transfer of undertakings ("*sucesión de empresa*"), currently contained in section 44 of the Statute of Workers Rights ("*Estatuto de los Trabajadores*").

(ii) The **acquirer's exemption of liabilities from previous debts** except in the following cases:

- The acquirer has declared the express assumption of the previous debts;
- The acquirer is a person which is considered to be "specially related to the debtor"; or
- In case of debts against the Social Security of the workers.

(iii) **Awarding powers to the judge conducting the insolvency proceedings to order the direct sale, or the sale of the asset via a specialized entity**, in case no offers were submitted at the auction, or when, in the light of the report issued by the insolvency administration, he considers it to be the most proper way to protect the interests of the parties involved in the insolvency proceedings.

(iv) **Judges will now have** the power to **award the asset to a bidder that has not offered the highest bid for the business or business unit,** if they deem such other **offer appropriate to protect the continuity of the business activity** of the debtor **and to satisfy the creditors' interests** to a greater extent. This power may only be exercised if the difference between the higher bid and that considered more appropriate does not exceed 10%.

(v) The inclusion of a specific regime, applicable to the transfer of **goods and rights, which are integrated in a business unit and are also affected by security**. Formerly, considerable hurdles would be encountered in any disposal of a business unit, since its most relevant assets would be affected by security and no provision governed the portion of the price to be allocated to secured creditors, or to what extent their consent would be required to proceed to the transfer.The following rules will apply to such a transfer:

- If such assets or rights are transferred **free of any security** (*i.e.*, security affecting the production or business unit will cause security to be terminated), the secured creditors will receive a percentage of the price representing the proportion of the value that such secured good or right represents for the value of whole "production unit".

    - If the amount such creditors are about to receive is **lower than the reasonable value of the guarantee**, the consent of a majority of at least 75% of the secured financial creditors affected by such transfer will be requested. The amount of security that has not been satisfied will be qualified according to its nature.

    - If the amount such creditors are about to receive is **at least the reasonable value of the security**, the transfer will take place even without the consent of the secured financial creditors affected by such transfer.

- If such assets or rights are **transferred without cancelling the existing security**, and the new owner assumes the position of the Borrower, the transfer will take place **even without the consent of the secured financial creditors** affected by such transfer, and the credit will be excluded from the estate. The possible negative effect this measure may have for the creditors pretends to be reduced by imposing an obligation to the judge to verify that the acquirer has the necessary financial solvency and the necessary means to assume the transmitted obligation.

4. OTHER AMENDMENTS:

4.1. Amendment of the Royal Decree-law 5/2005 of 11 March ("RDL 5/2005") and of the limitation of the judicial sanctioning to re-financing agreements.

By virtue of which, all acts derived from the implementation of the provisions of article 5 bis of the SIA and from the judicial sanctioning of the re-financing agreements set out under the fourth additional disposition of the SIA will be considered as **consolidation measures** ("*medidas de saneamiento*"), and the same effects provided under Title I, Chapter II of the RDL 5/2005 for the opening of the insolvency proceedings will apply to them.

This amendment has a great impact on the re-financing transactions, as nearly all re-financing transactions entail the provision of credit derivatives in order to secure a possible variation in interest rates (normally swaps), which will not be affected by the beginning of a judicial sanctioning of a re-financing agreement procedure. In practice, there is a real risk of frustration of many re-financing transactions due to the behaviour of the entities that own such securities.

In addition, the **one-year limitation** to apply for a new judicial sanctioning of a re-financing agreement will **not apply** to debtors who have entered into re-financing agreements during the year before the RDL 11/2014 came into force.

4.2. Amendment of the Law 9/2012 of 14 November of credit institution restructuring and dissolution.

By virtue of which, all credits transferred to the company in charge of the management of the assets deriving from the bank restructuring ("*Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria*" or "**SAREB**"), will be taken into account in order to calculate the

majorities set out under the fourth additional disposition of the SIA, so as to obtain a judicial sanctioning of the refinancing agreements, even when the SAREB shall be considered to be a person specially related to the debtor.

4.3. Amendment of Civil Procedure Act.

In order to comply with the judgment of the European Court of Justice of 17 July 2014, the possibility of filing an appeal against the resolution rejecting the opposition to enforcement, based on the abusive nature of a clause is introduced.

4.4. Amendment of the Companies Act ("CCA").

The shareholders faculty of exercising their right to separation in case of a lack of distribution of dividends, set out in article 348 bis of the CCA, is suspended until 31 December 2016.

4.5. Amendments in the securitization framework.

It is established that the transfer of securities issued by an asset securitization fund addressed to institutional investors, shall only be performed between investors belonging to this category, and they shall only be admitted to trading in a multilateral trading facility, in which issuance and subscription are restricted to qualified investors.

4.6. Establishment of a special regime applicable to insolvency of concessionaires of public works and utilities or contractors for public authorities.

Such regime is characterized by:

(i) The possibility of consolidating all the insolvency proceedings of concessionaires of public works and utilities, or contractors for public authorities before one single Court, in case of submission of composition agreement proposals which affect all of them.

(ii) The possibility of conditioning the approval of a composition agreement to the approval of the composition agreement proposals submitted in the rest of the consolidated insolvency proceedings.

(iii) The possibility of the public administrations, including the dependent or related agencies, entities and capital companies, to present composition agreement proposals.

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