

# **Debt restructuring in the UK and Spain:**

## *Is the grass still greener on the other side?*

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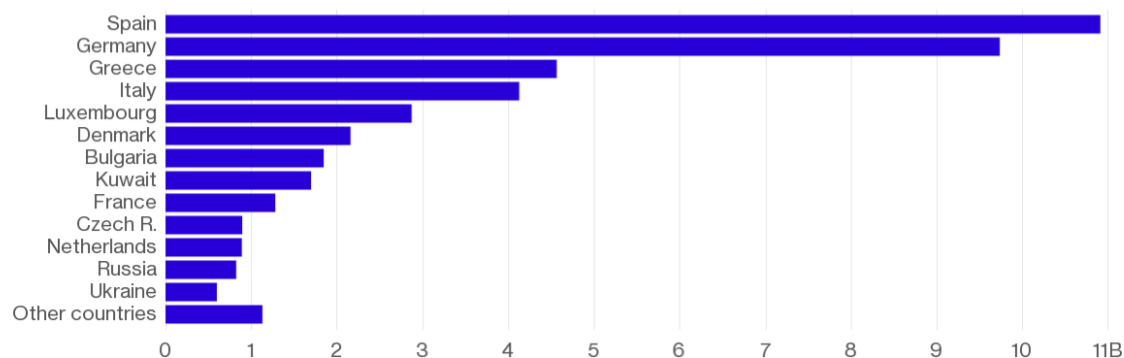
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## A. INTRODUCTION

### §1. Background

In the past decades, foreign companies have often resorted to the English scheme of arrangement as laid down in Section 895 of the UK Companies Act 2006 (hereinafter ‘CA 2006’) in order to restructure their debt.<sup>1</sup> English courts have generally been very accepting towards foreign companies applying for a scheme. Albeit settled common law requires a ‘sufficient connection’ with the UK’s jurisdiction, the mere fact that companies include a choice-of-law clause in favour of UK law and/or allocate jurisdictional power to the English courts in their contracts usually already satisfies English judges.<sup>2</sup> This flexibility has been quite beneficial to the restructuring of many international companies. Nonetheless, the leniency with which foreign companies can benefit from the UK schemes without even having their registered office or ‘centre of main interests’ (hereinafter ‘COMI’)<sup>3</sup> there, has been alleged to encourage ‘forum shopping’<sup>4</sup>, which the EU legislator in fact sought to prevent.<sup>5</sup> In this respect, it is interesting to focus on Spain, as it has been (and maybe still is?) one of the main suppliers of companies that restructured under Section 895 CA 2006 during the past years according to Bloomberg (see chart below).<sup>6</sup>

**Table I: Foreign Debt restructured in English Courts in USD (2009-2016)<sup>7</sup>**



<sup>1</sup> Jennifer Payne, ‘Cross-border schemes of arrangement and forum shopping’ (2013) 14(4) EBOR 563. Ignacio Tirado,

<sup>2</sup> *Re Drax Holdings* [2004] 1 WLR 1049; *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); *Re Public Joint-Stock Company Commercial Bank “Privatbank” and in the Matter of the Companies Act 2006* [2015] EWHC 3299 (Ch).

<sup>3</sup> Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings [2000] OJ L 160, Annex A.

<sup>4</sup> ‘Forum shopping’ in an insolvency context entails the practice whereby a debtor seeks a more favourable insolvency regime in another jurisdiction.

<sup>5</sup> Regulation (EU) 2015/848 of 20 May 2015 of the European Parliament and of the Council on insolvency proceedings (recast) [2015], recital 5 (formerly Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings [2000] OJ L 160, recital 4): “It is necessary for the proper functioning of the internal market to avoid incentives for parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position to the detriment of the general body of creditors (forum shopping).” However, a distinction should be made between abusive and fraudulent forum shopping (such as where a debtor attempts to move its COMI to take advantage of a more favourable bankruptcy regime), which the former and recast Regulation seek to prevent (*cf.* recital 29 and 31 recast Regulation), on the one hand, and ‘good’ forum shopping, on the other, when the purpose of the forum shopping aims to achieve the best possible outcome for both the company and its creditors (*cf.* Newey J in *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch)). For a discussion on good and bad forum shopping see A-G Colomer in *Case C-339/07 Seagon v. Deko Marty Belgium NV* [2009] ECR I-1767 (ECJ). See also Wolf-George Ringe, ‘Forum Shopping under the EU Insolvency Regulation’ (2008) 9 EBOR 579-620.

<sup>6</sup> Luca Casiraghi and Jeremy Hodges, ‘London Lure for Troubled Firms Threatened by Spanish Gamble’ (*Bloomberg* 6 November 2015) <<http://www.bloomberg.com/news/articles/2015-11-06/london-lure-for-troubled-firms-threatened-by-spanish-gamble>> accessed 16 February 2019.

<sup>7</sup> *Ibid.*

A study of this overseas ‘emigration’<sup>8</sup> of Spanish companies for restructuring purposes becomes even more interesting knowing that Spain has recently amended its Insolvency Act or ‘*Ley Concursal*’ (hereinafter ‘LC’).<sup>9</sup> In particular, the *homologación judicial de acuerdos de refinanciación*, i.e. a court-sanctioned refinancing agreement introduced in 2011, merits our attention as it is often referred to as the ‘Spanish Scheme of arrangement’.<sup>10</sup> Albeit this restructuring tool has been praised for the opportunities it offers distressed companies to restructure their debt outside formal insolvency proceedings, it has also been criticized for being ineffective and too rigid.<sup>11</sup> Nonetheless, Spain has been continuously reforming its (pre-)insolvency landscape ever since.<sup>12</sup> This study analyses this legislative evolution in Spain and aims to answer the question whether or not the *homologación judicial* can rightly be regarded as Spanish equivalent of the English scheme of arrangement.<sup>13</sup>

## §2. Research Aims

Broadly speaking, a comparative legal study can have two different principal objectives: (i) the accumulation of comparative knowledge as an end in itself; or (ii) comparative research as a means to achieve other insights or as *de lege ferenda* inspiration for future law reform.<sup>14</sup> This article hopes to achieve the latter. The findings resulting from the legislative comparison of the UK’s and Spain’s (pre-)insolvency framework could help us understand what it is that large Spanish companies in distress seek but do not find in their own domestic restructuring toolkit and what precisely encourages them to resort to the English scheme of arrangement to restructure their debts.

This study will focus on the equivalent restructuring mechanisms that Spanish insolvency law provides, compare them with the English scheme of arrangement and analyze their similarities and – more important – their differences from a corporate rescue perspective.

To this end, this article will shed light on the recent legislative reforms of the LC. Without jumping to conclusions, it could be argued that recent cases of Spanish companies applying for an English scheme of arrangement (e.g. *Codere* case<sup>15</sup>) indicate that the Spanish legislator still has work to do in order to make its (pre-)insolvency laws attractive to large businesses. In the course of this analysis, it will become clear whether the recent amendments deliver on their promises and, if not, which further reforms need to be implemented to enhance the LC’s restructuring toolkit.

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<sup>8</sup> We cannot really speak of an ‘emigration’ as a mere contractually agreed application of UK law already satisfies the conditions to benefit from a scheme of arrangement. Thus, Spanish companies do not even need to have an office in the UK (*Re Rodenstock GmbH* [2011] EWHC 1104 (Ch)).

<sup>9</sup> Spanish Insolvency Act 2003 (Ley 22/2003, de 9 de julio, Concursal).

<sup>10</sup> Chiara Elisei and Denise Ko Genovese, ‘Spanish legislators in proactive mood to facilitate debt refinancings but court discretion creates uncertainty’ (*Financial Times*, 14 October 2013) <[http://www.ft.com/cms/s/2/5c1f393a-34fc-11e3-8148-00144feab7de.html?ft\\_site=falcon&desktop=true&axzz48pM5f4MM](http://www.ft.com/cms/s/2/5c1f393a-34fc-11e3-8148-00144feab7de.html?ft_site=falcon&desktop=true&axzz48pM5f4MM)> accessed 28 January 2019.

<sup>11</sup> *Ibid.*

<sup>12</sup> Since the introduction of these court-sanctioned refinancing agreements in 2011 (Act 38/2011, of 10 October, amending Law 22/2003, of 9 July, on Insolvency), the following amendments have been improving the Spanish Scheme framework: Act 14/2013 of 27 September on support for entrepreneurs and their internationalisation; Act 26/2013 of 27 December on savings banks and banking foundations; Royal Decree-Law 4/2014 of 7 March 2014, on urgent matters in relation to refinancing agreements and debt restructuring; Act 17/2014 of 30 September adopting urgent measures on the refinancing and restructuring of corporate debt; Act 9/2015, of 25 May, on urgent measures in bankruptcy matters.

<sup>13</sup> In the author’s opinion, a comparison of these two countries is all the more compelling considering the differences in legal tradition and economic and political climate. First of all, English law has a common law tradition, which means that its legislation is largely based on case law and that consistency of legal rules is guaranteed by attributing great precedential weight to decisions of the higher UK courts. Spain, on the other hand, has a continental or civil law system that consists of codes as the primary source of law in which the legal rules are written down. Secondly, the financial and economic circumstances, which these states find themselves in, and how they evolved after the financial crisis of 2008 also differ to a great extent. Nonetheless, in spite of this cultural, historical and socio-economical divergence, case law suggests that the UK is better equipped to assist large Spanish companies in their financial restructuring.

<sup>14</sup> Stefan Vogenauer, ‘Sources of Law and Legal Method in Comparative Law’ in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (OUP 2006).

<sup>15</sup> *Re Codere Finance* (UK) Ltd [2015] EWHC 3778 (Ch).

An important additional element to be taken into account when making predictions about the success of Spain's recent reforms and, in particular, the introduction of its own scheme procedure, relates to the cross-border recognition and enforcement of both schemes - the Spanish *homologacion judicial* vs. the English scheme of arrangement - in light of the forthcoming Brexit deal between the EU and the UK. In this regard, this study will discuss the potential impact of Brexit on the English scheme's popularity among Spanish companies and the - potentially increased - use of their domestic out-of-court restructuring tools.

### §3. Methodology

This study will approach the aforesaid '*forum shopping*' practice from a functional perspective. A functional comparative methodology focuses on the differences between national solutions adopted or developed in practice to address similar societal needs (*i.e.* rescue of distressed companies by means of debt restructuring).<sup>16</sup> This methodology enables us to get a better understanding of the pros of the English scheme of arrangement and the cons of Spain's insolvency legislation that made large Spanish companies want to restructure overseas.

Hereinafter, the possibility for Spanish debtors to restructure their debt "out-of-court" will be analyzed thoroughly, compared with the English scheme of arrangement and finally scrutinized with regard to its effectiveness. Ultimately, this study aims to answer the question whether Spain's recent legislative efforts allow for an efficient out-of-court debt restructuring under the auspices of the LC, so that Spain's domestic insolvency laws are better equipped to compete with the flexible scheme procedure that the UK offers.

Considering the pragmatic nature of this methodology, a certain degree of contextualization is indispensable as to understand how certain laws operate in practice ('*law in action*').<sup>17</sup> Therefore, this study will include a comprehensive body of case law and empirical statistics.

To paraphrase Ernst Rabel, one of the founding fathers of this contextualized functionalism:

*"A legal rule without the case law relating to it is like a skeleton without muscles."*<sup>18</sup>

Due consideration should be given to socio-economical and historical factors that have significantly influenced (or still influence) the development of insolvency laws (e.g. views on corporate failure). This enables the comparatist to better understand the differences and similarities between various approaches in different legal systems.<sup>19</sup> Hence, whilst analyzing the incentives of large Spanish businesses to restructure under English law, one must never forget the climate in which legal rules have come into existence.

<sup>16</sup> This functional approach has been advocated by comparatist Ernst Rabel (David J. Gerber, 'Sculpting the Agenda of Comparative Law: Ernst Rabel and the Façade of Language' in Annelise Riles (ed), *Rethinking the Masters of Comparative Law* (2001) 199).

<sup>17</sup> See also Pierre Legrand 'The Impossibility of Legal Transplants' (1997) 4 Maastricht Journal of European and Comparative Law 111, 114.

<sup>18</sup> Original quote: "*Ein Gesetz ist ohne die zugehörige Rechtsprechung wie ein Skelett ohne Muskel.*" (Ernst Rabel, 'Aufgabe und Notwendigkeit der Rechtsvergleichung' (1924) *Rheinische Zeitschrift für Zivil- und Prozessrecht* 279); Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir, 3 edn, Clarendon Press 1998).

<sup>19</sup> John C. Reitz, 'How to do Comparative Law' (1998) 46 *AJCL* 617, 626.

## §4. Structure

In concrete terms, this essay will first discuss the rise of the English scheme of arrangement and the main reasons for its popularity among both UK as well as foreign companies. Subsequently, the issue of their recognition and enforcement outside the UK will extensively be elaborated on, especially in the light of the UK leaving the European Union in March 2019.

In the second part of this study, the recently amended *Ley Concursal* ('LC'), *i.e.* the Spanish Insolvency Act, will be analyzed from a debtor-oriented perspective, hereby taking into account the concerns of distressed enterprise groups seeking a viable restructuring solution. Spain's attempts to overcome the drawbacks of its insolvency laws and the introduction of the *homologación judicial de acuerdos de refinanciación* or, as commonly referred to, the 'Spanish Scheme' - named after its English inspiration - will be the main focus of this analysis.

Ultimately, this study will compare the founding father of court-sanctioned restructuring arrangements and its Spanish offspring, assess to what extent they are alike and consider the chances of scheme restructurings really taking off in Spain.<sup>20</sup>

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<sup>20</sup> It should be noted that, generally speaking, schemes can be divided into two groups: creditor-focused and member-focused schemes. Of course, this purely theoretical categorization does not preclude the possibility of a 'mixed' scheme affecting both creditors as well as members. Considering that this study aims to achieve a comparative analysis of the debt restructuring tools available in the UK and Spain, the observations made hereinafter will (solely) relate to the first type of schemes, namely creditor-focused schemes.



## B. ENGLISH SCHEME OF ARRANGEMENT

### §1. General

The scheme of arrangement is a statutory procedure under Part 26 (sections 895-901) of the UK Companies Act of 2006. In short, it can be regarded as a court-supervised commercial deal between a company and its creditors (or any class thereof)<sup>21</sup>, whose debt claims against the company or, at least, the contractual terms (e.g. maturity date interest rates, security interests) regarding these claims will be modified by virtue of the scheme. Typically, it is the company that initiates the scheme once it has negotiated a restructuring with its key stakeholders in advance.<sup>22</sup>

Generally speaking, the main objective of the procedure is to enable companies to reach an arrangement or compromise with a majority representing at least 75% in value of its creditors and to subsequently request the court for the homologation thereof, as a result of which the terms agreed thereunder will also bind all other creditors, even if they voted against the scheme or did not vote at all.<sup>23</sup> Therefore, the scheme procedure is a very interesting tool for companies in distress that wish to restructure their debts which would otherwise require individual consent of each creditor concerned.

Albeit the English scheme is not a formal insolvency procedure in the strict sense, the English courts are nonetheless involved to a certain extent: two court hearings are held during the process, *i.e.* the class composition meeting and the sanctioning meeting.

In concrete terms, the "procedural phase" - *i.e.* after the scheme has been informally negotiated between the company and its creditors in the months before - usually takes around 8-10 weeks and entails, broadly speaking, the following steps:

- Preparation of scheme documentation such as a practice statement letter, explanatory statement, final form restructuring documentation and security documents;
- Application for a hearing date to convene the first creditor meeting and issuance of a practice statement letter to inform the creditors of the course of the scheme process;
- At the first hearing, the court provides guidance as regards the convocation, but also - and more importantly - concerning the composition of the different creditor classes;
- Subsequently, a notice of creditor meetings and explanatory statement<sup>24</sup> is circulated to all creditors who will be affected by the scheme;
- Usually around 3 weeks after the explanatory statement has been circulated, the creditor meetings are held during which the restructuring proposal is presented to the creditors and voted on by.<sup>25</sup>

<sup>21</sup> Pursuant to section 895 CA 2006, a scheme of arrangement can also be concluded by a company and its members (or any class thereof). Having regard to the object of this study, *i.e.* restructuring debt rather than equity, this article will focus on rather creditor-oriented schemes and the position of a company's (key) creditors during the scheme process.

<sup>22</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014), 29; John Tribe, 'Companies Act Schemes of Arrangement and Rescue: the lost cousin of restructuring practice?' (2009) 24(7) *Journal of International Banking and Financial Law* 386, 387.

<sup>23</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2014), 175.

<sup>24</sup> The explanatory statement must explain in detail what the scheme is intended to achieve and its economic and legal effect (s.897 CA 2006).

<sup>25</sup> The required majorities during the creditor meetings will be further elaborated on in Chapter 2 under heading '2.2.3 Majority'.

- Finally, at the sanction hearing, the court reviews whether (i) all formalities (majorities, notices, etc.) have been complied with during the entire process; (ii) all creditor classes were fairly represented by those who attended the meeting(s) and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and (iii) the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.<sup>26</sup> Broadly speaking, the test is whether the scheme is commercially justifiable.<sup>27</sup> If satisfied, the court will sanction the scheme, thereby extending its effects to holdout and dissenting creditors.

It is important to remember that the role of the court is not merely a rubber-stamping exercise. Although the English courts have adopted a commercial, rescue-oriented attitude, there have been a number of cases in which a court did exercise its discretionary power to refuse the sanctioning of a scheme, especially if there are reasons to believe that the majority vote does not represent the views shared by the class as a whole.<sup>28</sup>

## §2. The Scheme's Popularity: First Impressions do *not* last!

### 2.1 From 'Zero' to 'Hero'

Though the English scheme procedure was initially considered to be too expensive and cumbersome due to overwhelming court involvement and its formal requirements (e.g. explanatory statement) it nonetheless became extremely popular among both UK as well as foreign companies at the turn of the century.<sup>29</sup>

The ability to 'cramdown' creditors, the lack of stigma and its flexibility have proven to attract corporate debtors worldwide to restructure their indebtedness under an English scheme. This chapter highlights and analyzes the main drivers for this reputation boost.

### 2.2. The Advantages of the English Scheme

#### 2.2.1 Cramdown

The increased popularity of the English scheme is primarily rooted in the ability of the creditor majority to bind the dissenting minority, regardless of whether their claims are secured or not.

In order to get some financial 'breathing space', a company may seek to alter the rights of its creditors by informally negotiating consensual arrangements with them. One can think of a reduction of debt or

<sup>26</sup> *Re Anglo-Continental Supply Company Limited* [1922] 2 Ch 723; *Re National Bank Ltd* [1966] 1 WLR 819; *Re Anglo American Insurance Co Ltd* [2001] 1 BCLC 755; *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; [2001] BCC 300.

<sup>27</sup> To be regarded as fair, the company may have to show that the junior creditors are out of the money, *i.e.* without a chance of receiving a dividend from the company's liquidation, and therefore are not necessary to be involved in the scheme restructuring. (e.g. *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch); [2009] EWHC 2114 (Ch), [2010] 1 BCLC 338, § 25)

<sup>28</sup> *Re BTR plc* [2000] 1 BCLC 740. As it was stated in this case by LJ Chadwick at page 747g–h: "But if the court is satisfied that the meeting is unrepresentative, or that those voting at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote in favour of the resolution is not to be given effect by the sanction of the court."

<sup>29</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (CUP 2014), 2; see also *Report of the Joint DTI/treasury Review of Company Rescue and Business Reconstruction Mechanisms* (London: TSO, 2000), §43; Report of the Insolvency Law Review Committee (Cork Committee), *Insolvency Law and Practice* (Cmnd 8558, 1982) Ch. 7.

an extension of the maturity date under its financing agreements. However, strictly speaking, no creditor can be bound to such modification of its rights if it did not consent to it. Modifying the terms of financing documents usually requires unanimous consent or at least the approval of a supermajority of creditors (90%). As a result, small creditors have the power to block a compromise, despite the support of the majority of creditors.

Consequently, holdout creditors may force creditors with greater exposure to pay them off.<sup>30</sup> Having a keen eye for lucrative business, investors started to invest in distressed debt with the sole view to create nuisance value and get a return on their investment by acting as holdout creditors. After all, claims against companies in distress can often be acquired for a fraction of their nominal amount. Hence, the investment risk of receiving no or only a meager distribution from the company's liquidation is negligible compared to the chances of getting a much higher return by not consenting or 'holding out' and getting paid off by other creditors.<sup>31</sup>

Part 26 of the CA 2006 attempts to offer companies a way out of this precarious situation by introducing a lower approval threshold of 75% in value and a majority in number of each class of creditors. Once the court sanctions the scheme, dissentient creditors will be equally bound to the scheme and thus 'crammed down' by virtue of statute. As a result, minority creditors are no longer able to block a compromise or arrangement to which the majority of creditors has agreed. In practice, even the mere threat of a cramdown may already lead to consent being reached consensually.<sup>32</sup>

## 2.2.2 Flexibility

Another significant advantage of the English scheme is its flexibility as there are no statutory limits to what can be proposed in a scheme. Section 895 CA 2006 merely speaks of a "*compromise*" or "*arrangement*" between the company and "*its creditors (or any class of them)*". As a result, schemes can be tailored to the specific needs of a company.<sup>33</sup>

### 2.2.2.1 "A compromise or arrangement ..."

Due to the absence of a legal definition, these terms have been interpreted by the English Courts very widely on the basis of their commercial meaning.<sup>34</sup> Pursuant to settled case law, both terms imply some element of 'give and take' and not just a relinquishment of rights.<sup>35</sup> However, this 'give and take' principle does not entail that there can be no disadvantage to creditors.<sup>36</sup> The proposed scheme must

<sup>30</sup> Key creditors might have a significant interest in keeping the debtor economically 'alive' as this may not only increase the value of the business and, thus, the chances of their claims being (fully) repaid, but it might also further their professional relationship and business opportunities in the future.

<sup>31</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 9.

<sup>32</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 10 with reference to the restructurings of MyTravel, Gala Coral and Crest Nicholson in which the bondholders ultimately accepted a consensual deal after the said companies applied for a scheme.

<sup>33</sup> It must be noted that the "compromise or arrangement" must be between the company and its creditors for the purpose of section 895 CA 2006. The company itself must be a party to the scheme, irrespective of the fact that section 896 CA2006 explicitly allow creditors/members to apply for a scheme as well. In practice, this means that the company, whether through its board of directors or by its body of shareholders, must approve the scheme (*Re Savoy Hotel Ltd* [1981] CH 351 CH D). Hence, a scheme cannot be imposed on the company unless it has consented to it.

<sup>34</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 20; Geoff O'Dea, Julian Long and Alexandra Smyth, *Schemes of arrangement: law and practice* (Oxford, OUP 2012) 35.

<sup>35</sup> *Re Savoy Hotel Ltd* [1981] Ch 351, paras 359-361; In *Re NFU development Trust Ltd*, the court refused to sanction the scheme on the basis that the scheme proposed a total surrender of rights on behalf of the members and a claimant that abandons his claim is not compromising it (*Re NFU development Trust Ltd* [1972] 1 WLR 1548).

<sup>36</sup> In *Re Osiris Insurance*, an insurance company sought to compromise claims of insurance holders with a view to achieve a solvent run-off. Notwithstanding the disadvantages of a run-off lasting several years, the court nonetheless sanctioned the scheme as it provided for accelerated payouts to the creditors and an efficient procedure for agreeing, adjudicating and satisfying claims (*Re Osiris Insurance Ltd* [1999] 1 BCLC 182).

be reasonable in the eyes of the court.<sup>37</sup> This debtor-friendly interpretation leaves much room for creativity when negotiating a debt restructuring.<sup>38</sup>

An illustration of this flexibility is the 'debt-for-equity swap', whereby a company offers shares to its creditors in exchange for a reduction of its debt.<sup>39</sup> Other notable examples are the inventive creditor schemes of Spanish clothing retailer Cortefiel and German television network operator Primacom<sup>40</sup>, the reduction of contingent injury claims in *Re T&N Ltd*<sup>41</sup> and the restructuring of pension liabilities in the *Re Uniq Plc* scheme.<sup>42</sup>

#### 2.2.2.2 "...between a company and its creditors ..."

Section 895 CA 2006 refers to a compromise or arrangement proposed between a company and "its creditors or any class of them".

Likewise the above discussed concepts 'compromise' and 'arrangement', section 895 CA 2006 does not delineate what is meant by the term 'creditor'. As the main purpose of the English scheme is the financial rehabilitation of a distressed company, the English courts interpreted this term broadly.<sup>43</sup> A 'creditor' in the sense of section 895 CA 2006 has been held to encompass "anyone who has a monetary claim against the company that, when payable, will constitute a debt".<sup>44</sup> As such, the term does not only include actual but also contingent creditors, *i.e.* anyone to whom a sum will become payable in the future on the grounds of a present obligation.<sup>45</sup>

Also secured creditors can be crammed down under a scheme of arrangement. This is not surprising as security rights often play an important role in the debtor-creditor relationship.<sup>46</sup> As a matter of fact, schemes often involve the modification or removal of security rights.<sup>47</sup>

<sup>37</sup> *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213.

<sup>38</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 36-40.

<sup>39</sup> e.g. *Re Telewest Communications plc* [2004] EWHC 924 (Ch) and *Re Uniq plc* [2011] EWHC 749 (Ch)

<sup>40</sup> In *Re Primacom Holding*, the company's scheme included a structural subordination of mezzanine debt with a view to alleviate the debt burden on the group (*Re Primacom Holding GmbH* [2012] EWHC 164 (Ch); [2013] BCC 201).

<sup>41</sup> In *Re T & N Ltd*, current and former employees of 58 associated companies had suffered asbestos injuries. Schemes were proposed in order to achieve a compromise with the companies' insurers, who were eager to determine the quantum of their liabilities. Both potential and actual claimants in respect of asbestos injuries were held to be creditors for the purposes of section 425 of the Companies' Act of 1985 and could therefore participate in the scheme process (*Re T & N Ltd (No.2)* [2005] EWHC 2870 (Ch); [2006] 1 WLR 1728).

<sup>42</sup> In *Re Uniq plc*, the company's members exchanged more than 90% of their shares, plus 14 million GBP for the release of pension liabilities (*Re Uniq plc* [2011] EWHC 749 (Ch)).

<sup>43</sup> Unsurprisingly, a 'creditor' in the sense of section 895 CA 2006 is not the same as a creditor in other (potentially connected) fields of law (e.g. in insolvency law). See *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213; *Re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267; *Re R. L. Child & Co Pty Ltd* (1986) 10 ACLR 673.

<sup>44</sup> *Re Lehman Brothers International (Europe) (in administration)* [2009] EWCA Civ 1161; [2010] BCLC 496, § 58.

<sup>45</sup> *Re Cancel Ltd* [1996] 1 All ER 37. Notwithstanding, it should be noted that the creditor and the claim must 'exist' at the time of the order convening the relevant class meetings (*Re B & S Distributor Pty Ltd* [1986] 5 NSWLR 492).

<sup>46</sup> Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press) 176 and 182: "The security right is an integral part of the debtor-creditor relationship between the company and creditor, and as a result a scheme can legitimately alter those security rights in the same way as it can alter other aspects of the debtor-creditor relationship."

<sup>47</sup> Both UK as well as foreign companies have sought to alter security rights of creditors by means of a scheme of arrangement (*Re Bluebrook Ltd* [2009] EWHC 2114 (Ch); [2010] 1 BCLC 338; *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2012] BCC 459; *Re Lehman Brothers International (Europe) (in administration)* [2009] EWCA Civ 1161; [2010] BCLC 496, § 82; *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch); [2013] BCC 201. In fact, Spanish companies have used English schemes for altering security rights in their debt restructurings due to the fact that Spain's insolvency law did long not provide for a cramdown of secured creditors and still does not foresee explicitly in the possibility for the amendment or cancellation of security interests (contra: *Bodybell* case). See *infra* part C, '3.6 The Spanish Scheme: 4 years' practice' (Part C: Corporate Rescue in Spain).

## 2.2.2.3 “... or any class of them”

Albeit an English scheme can compromise both ordinary as well as secured creditor claims,<sup>48</sup> it should be noted that creditors can still only be crammed down *within* a particular ‘class’.<sup>49</sup> Section 895 CA 2006 obliges every company to divide its creditors into different classes and convene a separate meeting for each class. This categorisation requirement is one of the main reasons that schemes used to be considered as complex and cumbersome. However, it is fair to say that the impact of this obstacle has been reduced to a great extent owing to the courts’ commercially oriented attitude towards the determination of creditor classes.<sup>50</sup>

In the *Sovereign Life Assurance* case, Bowen LJ held that a ‘class of creditors’ consists of creditors whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.<sup>51</sup> When applying this test to a pool of creditors, a balance should be struck: on the one hand, the formation of classes should be broad enough to ensure that no veto power is unnecessarily given to a minority group; on the other hand, a minority creditor should not be unfairly crammed down by a creditor majority with dissimilar rights.<sup>52</sup>

Furthermore, in *Re Hawk Insurance* the court ruled that the “*Sovereign Life*-test” should not only take the rights that are to be released or varied under the scheme into account, but also the new rights resulting from its implementation.<sup>53</sup> Indeed, before dividing the company’s creditors in different classes, one must identify whose rights will be varied by the scheme and to what extent.<sup>54</sup>

During the years, the English courts have adopted a practical approach, not allowing too many creditor classes to be created, which would only increase the chances of holdouts and jeopardize the success of the scheme.<sup>55</sup>

In this regard, it should also be kept in mind that a company is generally free to choose with whom it concludes a scheme of arrangement, as long as this is commercially justifiable.<sup>56</sup> The other creditors are not bound by the scheme and retain their full rights. This is an important characteristic of the

<sup>48</sup> *Re Empire Mining Co* [1890] 44 Ch D 402; *Re Alabama, New Orleans, Texas & Pacific Junction Railway Co* [1891] 1 Ch 213, 246; *Re Lehman Brothers International (Europe)* [2009] EWCA Civ 1161; [2010] BCLC 496, §60 and §70.

<sup>49</sup> A so-called ‘cross cramdown’, i.e. a cramdown *across* different creditor classes, is not possible in theory. In practice however, the cramdown of an entire class can *de facto* be achieved by combining a scheme with a pre-pack administration. A good example of this is the use of a scheme twinned with pre-pack administration to effectively sideline junior or subordinated creditors such as mezzanine lenders, which was the case in *Re Bluebrook Ltd (Re Bluebrook Ltd)* [2009] EWHC 2114 (Ch.). The limited ambit of this article does not allow the author to go deeper into this restructuring strategy, which has been developed in practice. See also *infra* 2.2.2.4 ‘Out-of-the-money’ creditors’ (Part B: English Scheme of Arrangement).

<sup>50</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 6 with reference to David Richards J in *Re Telewest Communication plc* [2004] EWHC924 (Ch).

<sup>51</sup> *Sovereign Life Assurance Co v. Dodd* [1892] 2 QB 573, §583.

<sup>52</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 5.

<sup>53</sup> *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; [2002] BCC 300, §30.

<sup>54</sup> This requires an examination of their respective rights under the compromised creditor agreements (secured/unsecured, control/voting under the documents, etc) and what they are being offered out of the scheme. For example, under the scheme of the Spanish clothing retailer Cortefiel, the senior facilities agreement was amended in order to enable the company to buy back debt with ‘excess cash flow’. Any excess cash not used for this purpose had to be mandatorily prepaid to the lenders *pro rata*. As the right to repayment, whether by way of a buyback or prepayment, was common to all lenders, the court ruled that this negligible difference did not justify two separate creditor classes (*cf. Cortefiel SA v MEP 11 S.a.r.l.* [2012] EWHC 2998 (Ch), §9).

<sup>55</sup> See *Re BTR plc* [2000] 1 BCLC 740; *Re Telewest* [2004] EWHC 924 (Ch.); *Re Cattles Plc* [2010] EWHC 3611 (Ch.). In *Re Telewest* David Richards J., while recognizing that cases on the composition of classes and the summoning of meetings had concerned different rights in very different circumstances, held: “*Nonetheless, those cases do indicate that a broad approach is taken and that the differences may be material, certainly more than de minimis, without leading to separate classes*” (*Re Telewest* [2004] EWHC 924 (Ch.), §37). See also Geoff O’Dea, Julian Long and Alexandra Smyth, *Schemes of arrangement: law and practice* (Oxford, OUP 2012) 50.

<sup>56</sup> A company can exclude any member or creditor from the scheme who is so powerful that he would simply vote against a modification of their creditor rights (e.g. *Sea Assets Ltd v Perusahaan Perseroan (Persero) PT Perusahaan Penerbangan Garuda Indonesia* [2001] EWCA Civ 1696).

English scheme in cases where a company wants to exclude certain creditors from its restructuring proposal.<sup>57</sup>

#### 2.2.2.4 ‘Out-of-the-money’ creditors

The scheming company should in principle not consult nor obtain the approval of creditors whose rights remain unaffected under the scheme (i.e. ‘out-of-the-money creditors’). It has been suggested by some judges in the past that creditors with claims ranking below ‘where value breaks’ have *de facto* no interest in the restructuring of the company and that a scheme could therefore be sanctioned despite their dissent.<sup>58</sup>

However, the approach taken by the courts today is that a scheme will not be sanctioned, if it has not been approved by all creditor classes.<sup>59</sup> English judges will only accept a cramdown *within* a class, but not *across* different classes.<sup>60</sup> Though this evolution is regrettable from a corporate rescue perspective, it is important to remember that a company can choose which creditors it includes in its scheme.

To overcome this inconvenience and to achieve the same result as a ‘cross-class cramdown’, debtors have come up with inventive schemes twinned with a pre-pack sale of their business assets. These schemes involved the novation or conversion of senior debt into share capital of a newly incorporated group entity (the so-called ‘NewCo’). Once the scheme had been sanctioned, the business and its assets would be transferred to the NewCo, leaving the dissenting creditor class in an empty shell company.<sup>61</sup>

#### 2.2.2.5 Release of Third Party Claims

The question whether a scheme can be regarded as an arrangement between a company and its creditors if it involves the release of rights *vis-à-vis* third parties has arisen before the English courts. Important to keep in mind is that an English scheme is characterized by some degree of ‘give and take’. In the landmark case *Re T&N Ltd*, the court ruled that this ‘give and take’ does not necessarily need to exist between the creditors and the company, but that it can also be found in the relationship between creditors and a third party as long as the compromised rights are part of a single arrangement

<sup>57</sup> Even a scheme with only one creditor is possible (cf. *Taurusbuild Ltd v. Svenska Handelsbanken*, unreported, 16 December 1994).

<sup>58</sup> This will be the case when the realization of the company's assets in case of liquidation is unlikely to generate a return to these creditors anyway. See for example *Re Tea Corporation Ltd* [1904] 1 Ch 12, which was later confirmed *Re Oceanic Steam Navigation Co Ltd* [1939] CH 41 and *Cambridge Gas Transport Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2006] UKPC 26; [2007] 1 AC 508 as referred to in Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 43.

<sup>59</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 44.

<sup>60</sup> *Ibid.*, at 241. It is worth noting that the Department for Business, Energy & Industrial Strategy and The Insolvency Service acknowledged the need for a cross-class cramdown and announced in a public consultation that under certain conditions a cross-class cramdown mechanism should be available for the purpose of the English scheme procedure (Department for Business, Energy & Industrial Strategy and The Insolvency Service, *Consultation on insolvency and corporate governance: government response* (Insolvency and Corporate Governance, 26 August 2018) 69-73 <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 24 February 2019).

<sup>61</sup> e.g. *Re Bluebrook Ltd*. [2009] EWHC 2114 (Ch.); [2010] 1 BCLC 338; *Re McCarthy & Stone plc* [2009] EWHC 1116 (Ch.). A good example of this is the *Bluebrook* restructuring in which the mezzanine creditors were effectively sidelined in the financial restructuring of a company. In this case a number of schemes were concluded between the company and the statutory majority of its senior lenders. These schemes involved the business and assets of the group being transferred to a new corporate structure consisting of new companies of which the senior lenders received shares in exchange for a reduction of their debt claims. As a result the new group entity would be mainly owned by the senior lenders and the former group would not retain an interest. The mezzanine lenders were shut out from these schemes and stranded in a group company with no assets left to pay them back. This “twinning” strategy thus achieved the same result as a cramdown of a whole class. Unfortunately, the ambit of this article does not allow the author to go deeper into this restructuring strategy. For further information, see Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 247 and Sarah Paterson, ‘Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards’ (2014) 14(2) *JCLS* 333.

affecting all parties to the scheme.<sup>62</sup> At present, it is settled case law that the release of claims against third parties such as guarantors or joint obligors - i.e. mostly entities within the same group as the debtor - also falls within the scheme jurisdiction of the courts, provided that the claims concerned are rooted in the same company-creditor relationship and that the release is indispensable to give effect to the arrangement between the company and its creditors.

The case law developed conditions for a third party release are mainly the following: *i)* the compromise involves a genuine 'give and take' between the third party and the company's creditors; *ii)* the creditor's rights against the third party are sufficiently closely connected with its rights as creditor against the scheme company; *iii)* the creditor's right against the third party are personal, not proprietary; and *iv)* the creditor benefits from the release of its rights against the third party, to the extent that if it were to exercise them this would adversely affect what it might recover under the scheme.<sup>63</sup>

The possibility to include claims vis-à-vis joint obligors or guarantors in a scheme is quite logical from the objective of a debt restructuring. Among other reasons, the fact a claim under such a guarantee, if pursued by the creditor(s) concerned, would give rise to a subrogation by the guarantor as result of which the latter in turn will have a claim against the company, would undeniably defeat the purpose of the scheme.<sup>64</sup>

Insolvency legislation in continental Europe generally still requires the individual consent of each creditor who benefits from a third party guarantee in order for the effects of the scheme to extend to the guarantor.<sup>65</sup> This is also the case in Spain:<sup>66</sup> creditors retain their rights vis-à-vis third parties, hereby not rarely jeopardizing the opportunity for debtors to achieve a workable debt restructuring with their creditors (e.g. the scheme of La Seda de Barcelona<sup>67</sup>).

### 2.2.3 Majority

The creditor approval threshold for a scheme is set at a majority in number (headcount test), representing at least 75% in value, of the creditors present and voting. In other words, absent and non-voting shareholders will not be included for the purpose of calculating the majority. Accordingly, the required majority could even be reached when the creditors voting in favour at the meeting do not hold 75% of the total value of creditor claims or a majority in number of the class as a whole. Albeit the absence of a quorum requirement may seem unfair at first sight, it does not cause any difficulties in practice as the courts have the discretionary power to disallow the sanction of a scheme in case the creditor class has not been fairly represented.<sup>68</sup> Notwithstanding, in *Re British Aviation Insurance Co Ltd*<sup>69</sup>, the court held that a low turn-out *an sich* is not a sufficient ground to disregard a scheme

<sup>62</sup> *Re T&N Ltd (No. 3)* [2006] EWHC 1447 (Ch); [2007] 1 All ER 851.

<sup>63</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 24. See also *Re Lehman Brother (Europe) International (in administration)* [2009] EWCA Civ 1161; [2010] 1 BCLC 496 and *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch); [2011] 1 BCLC 555; *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch).

<sup>64</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 24 with reference to *Re Lehman Brother (Europe) International (in administration)* [2009] EWCA Civ 1161; [2010] 1 BCLC, §65.

<sup>65</sup> e.g. art. 254(2) Insolvenzordnung (Germany) and art. 135.1 Ley Concursal (Spain).

<sup>66</sup> In relation to the Spanish Scheme, section 9 of AP4 LC provided that "*creditors holding financial liabilities who have not signed the homologation agreement, or who have expressed their disapproval thereof but who are affected by the homologation, shall preserve their rights against those bound jointly and severally with the debtor and before its backers and guarantors, who may not invoke neither the approval of the refinancing resolution nor the effects of the homologation to their detriment.*"

<sup>67</sup> *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch); [2011] 1 BCLC 555.

<sup>68</sup> e.g. *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213.

<sup>69</sup> *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch.); [2006] BCC 14.

supported by the majority of creditors present at the meeting.<sup>70</sup> The fair representation of a class will subsequently be assessed during the sanction hearing on a case-by-case basis.

Although the above majorities seem rather easy to achieve, the 'majority in number' requirement or 'headcount test' is far from uncontroversial. There have been number of calls in England for its repeal, as it is perceived as "irrelevant and burdensome".<sup>71</sup>

Early 2017, the proposed takeover of water company Dee Valley Group plc once again stirred up this debate. An employee who was not in favour of the scheme bought shares of the company and subsequently 'split' and distributed its shareholding among 445 individuals by way of a gift with the sole purpose to achieve a majority in number of (objecting) shareholders and to defeat the proposed scheme. As a result, at the court hearing more than 75% in value of the shareholders voted in favour of the scheme, whereas the majority in number threshold was not met as 466 out of 828 shareholders voted against the scheme.<sup>72</sup>

Although the above case concerned a takeover scheme and not a creditor scheme, which does not lend itself so much to debt (instead of share) splitting<sup>73</sup>, it is nonetheless clear that the headcount test can cause serious problems and may even thwart the entire scheming process. By any chance, this headcount requirement might be abolished in the near future.<sup>74</sup>

#### 2.2.4 Challenge

Another advantage is the certainty that a scheme of arrangement offers to companies and their creditors. Once the court has sanctioned a scheme, it will be very hard for opposing creditors to challenge it. A scheme will only be repealed in very limited circumstances, particularly if the consent of the creditors was obtained by fraud.<sup>75</sup>

#### 2.2.5 No Formal 'Insolvency Procedure'

Unlike most debt restructuring procedures, the English scheme procedure has always been part of UK company law and is therefore not considered to be an 'insolvency procedure' in the formal sense, i.e. being governed by insolvency legislation. Albeit this may appear to be merely a formalistic detail, its absence in the UK Insolvency Act of 1986 has truly been a decisive consideration for companies to opt for an English scheme as a means to restructure their debt.

##### 2.2.5.1 No stigma

Due to its company law nature schemes are far less associated with insolvency and bankruptcy than other restructuring procedures adopted under UK insolvency legislation. After all, section 895 CA 2006 does not contain any precondition with regard to the (negative) financial situation of the scheming company. Also profitable businesses have frequently used the scheme procedure in the past

<sup>70</sup> Provided that there is no indication of coercion or unfair treatment of the minority and the creditors have been assisted in reaching a decision and all relevant facts have been disclosed (*Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch.); [2006] BCC 14).

<sup>71</sup> Company Law Review (CLR), *Modern company Law for a Competitive Economy: Final Report*, URN 01/942, July 2001, para. 13.10.

<sup>72</sup> *Re Dee Valley Group plc* [2017] EWCH 184 (Ch).

<sup>73</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 66 et seq.

<sup>74</sup> See Department for Business, Energy & Industrial Strategy and The Insolvency Service, *Consultation on insolvency and corporate governance: government response* (Insolvency and Corporate Governance, 26 August 2018) 70 <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 24 February 2019.

<sup>75</sup> unless the court believes that the result would have been the same when the fraud did not occur, cf. *Fletcher v Royal Automobile Club Ltd* [2000] 1 BCLC 331; *British & Commonwealth Holdings plc v. Barclays Bank plc* [1996] 1 BCLC 1.



for various purposes (e.g. takeovers)<sup>76</sup>. In other words, the English scheme can be a valuable tool for successful companies too. As a consequence, an English scheme does not stigmatize the restructuring company, which is crucial to its chances of corporate recovery as the opening of a formal procedure often equals admitting to bankruptcy in the eyes of customers, suppliers and staff, who might be inclined to try and flee the sinking ship. This negative perception towards formal insolvency procedures also has an enormous impact on the company's value.<sup>77</sup>

#### 2.2.5.2 Early intervention

Furthermore, the fact that the application for an English scheme is not conditioned on imminent or actual insolvency makes it a very effective restructuring tool. The ability to restructure and head off liquidation in an early stage is one of the most valuable characteristics of the English scheme, especially for companies whose business is still economically viable.<sup>78</sup> The chances of overcoming imminent bankruptcy by means of 'traditional' in-court procedures (e.g. administration in the UK<sup>79</sup> or *concurso* in Spain<sup>80</sup>) are rather low given that, *inter alia*, these remedies can often only be initiated when insolvency has already spread out.

#### 2.2.5.3 No Stringent Insolvency Legislation

Furthermore, the usual insolvency law rules that would normally apply to formal proceedings do not apply to schemes. Upon the opening of formal proceedings the existing management will often be sidelined, as the failure of a company is often thought to be the result of poor management. As a consequence, an external insolvency practitioner will usually be put in charge of the company's rescue.<sup>81</sup> In a scheme procedure, on the other hand, the existing management will retain control of the company. Besides, part 26 CA 2006 also does not provide for statutory powers of investigation or any specific statutory provision to challenge preferences or undervalue transactions.<sup>82</sup>

#### 2.2.6 International Jurisdiction

Considering that it falls outside the scope of the (recast) EU Insolvency Regulation, a debtor can apply for an English scheme, whilst being incorporated and operating abroad without the need to have its 'centre of main interests' (COMI) or even any assets on English territory. Therefore, the English scheme of arrangement can be particularly useful where local law fails to provide efficient restructuring tools.

This use of English Schemes by foreign debtors will be analyzed more extensively in the following chapter.

<sup>76</sup> e.g. *Re Dee Valley Group plc* [2017] EWCH 184 (Ch).

<sup>77</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 230.

<sup>78</sup> *Re Cape plc* [2006] EWHC 1316 (Ch); [2006] 3 All ER 1222.

<sup>79</sup> Section 8 (1) (a) of the UK Insolvency Act of 1986: "if the court is satisfied that a company is or is likely to become unable to pay its debts".

<sup>80</sup> Art. 2.3 de Ley 22/2003, de 9 de julio, Concursal ('Spanish Insolvency Act'): "Si la solicitud de declaración de concurso la presenta el deudor, deberá justificar su endeudamiento y su estado de insolvencia, que podrá ser actual o inminente. Se encuentra en estado de insolvencia inminente el deudor que prevea que no podrá cumplir regular y puntualmente sus obligaciones." (freely translated: "If the debtor submits an application for a declaration of bankruptcy, he must justify his indebtedness and his state of insolvency, which may be current or imminent. The debtor is in a state of imminent insolvency if he foresees that he will not be able to fulfil his obligations regularly and punctually.")

<sup>81</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 233.

<sup>82</sup> Important to note is that such transactions, especially with insiders or connected persons, can nonetheless be challenged through statutory provisions of corporate law and case law in this regard (cf. Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 231).

## §3. Foreign Use of English Schemes

### 3.1 Introduction

Having regard to the multiple benefits of the English scheme discussed in the previous chapter, it does not come as a surprise that this restructuring tool caught the attention of struggling businesses worldwide. Supported by the speed of access to and the commercial attitude of the English courts, the scheme of arrangement has proven to be a solid, predictable procedure for restructuring debt, not only for national but also for foreign companies.

Foreign companies even often explicitly include the possibility to restructure under English law in their credit contracts, for in case unforeseen financial difficulties would come up.<sup>83</sup> Whether this practice of inserting jurisdiction and governing law clauses in financing contracts continues to suffice for the English courts to assert jurisdiction and the subsequently sanctioned schemes to be effective overseas - especially in light of the forthcoming Brexit - will be further discussed hereafter.

### 3.2 English Domestic Law

#### 3.2.1 “Sufficient Connection”

A ‘company’ in the sense of s.895(2) CA 2006 means “*any company liable to be wound up under the Insolvency Act 1986*”. Apart from companies registered under the laws of England and Wales, this definition also includes unregistered companies, which are defined as “*any association and any company, with the exception of a company registered under the CA 2006 in any part of the UK*” in the IA 1986.<sup>84</sup> In other words, nothing precludes companies incorporated elsewhere from being liable to be wound up under the IA 1986 and, therefore, from applying for an English scheme.

However, this does not mean that the English courts can simply wind up every foreign company. Settled case law prescribes three conditions for a foreign company to be liable to be wound up under the IA 1986: (1) a sufficient connection with England;<sup>85</sup> (2) a reasonable possibility of benefit to those applying for the winding-up order; and (3) one or more persons interested in the distribution of the company’s assets over whom the court can exercise a jurisdiction.<sup>86</sup>

After years of controversy about how these conditions may affect the sanctioning of schemes,<sup>87</sup> Lawrence Collins J acknowledged in *Re Drax Holdings* that only the ‘sufficient connection’ is required for the purpose of scheme jurisdiction.<sup>88</sup> Whether a company has a sufficient connection to England or Wales is a matter of court discretion and will be assessed on a case-by-case basis.

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<sup>83</sup> e.g. *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch); [2013] BCC 201. In the said case the scheming company was a Germany company without its COMI or any establishment in the UK, nor did it have any creditors domiciled in England or Wales. The fact that all creditor arrangements were governed by English law was sufficient for the English court to allow the company to apply for a scheme. See also *Re Seat Pagine Fialle SpA* [2012] EWHC 3686 (Ch); *Re NEF Telecom Company BV* [2012] EWHC 2944 (Comm); *Re Vietnam Shipbuilding Industry Groups* [2013] EWHC 2476 (Ch).

<sup>84</sup> Insolvency Act 1986, s.221(1) *juncto* s.220. See also Ian Fletcher, ‘The Law Of Insolvency’ (London, Sweet and Maxwell 2009) 669.

<sup>85</sup> which can, but does not necessarily have to, encompass assets within the jurisdiction.

<sup>86</sup> *Re Real Estate Development Co* [1991] BCLC 210, §217.; *Re Latreefers Inc* [2001] BCC 174.

<sup>87</sup> In particular, it was disputed whether these three conditions constituted strict limits on the court’s jurisdiction, or were simply principles to be taken into account by the court when exercising its discretion in determining whether to sanction a scheme.

<sup>88</sup> *Re Drax Holdings Ltd* [2003] EHCW 2743 (Ch); [2004] 1 WLR 1049 (later confirmed in *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2012] BCC 459).

In *Re Drax Holdings* a sufficient connection with England was established on the fact that English law governed the key finance documents of the company applying for the scheme.<sup>89</sup> Later, this view was confirmed and schemes applied for by foreign companies that were solely connected to England by a choice-of-law clause in their credit agreements were increasingly sanctioned by the English courts.<sup>90</sup> Even a last-minute change of governing law was held to be sufficient to constitute a legitimate ‘sufficient connection’ for the purpose of scheme jurisdiction.<sup>91</sup>

It seems self-evident, or at least appropriate, that if creditors have voluntarily submitted themselves to English law in their contractual dealings with the debtor,<sup>92</sup> the possibility of being crammed down under an English scheme is justified as well.

However, recently foreign companies petitioning for English schemes are experiencing increased scrutiny by the English courts and the mere presence of (one-way) jurisdiction clauses might no longer satisfy the courts to assert jurisdiction (*infra*).<sup>93</sup>

This does not necessarily mean that the English courts are no longer acceptable towards foreign scheme applications. On the contrary, the *Codere* case, for instance, proves the continued willingness of the courts to sanction schemes of foreign companies. In the said case, the debtor initially had no apparent connection to the UK. Nonetheless, by incorporating a new English company and making it co-issuer of the notes to be restructured, the private gaming multinational was able to demonstrate ‘sufficient connection’ and persuaded Newey J to assume jurisdiction and sanction *Codere*’s scheme.<sup>94</sup>

### 3.2.2 Overseas Effectiveness

Another important consideration for the English courts to exercise jurisdiction pertains to the likelihood of the scheme given effect in the debtor’s home state.<sup>95</sup> This question of effectiveness particularly came to the courts’ attention after the decision of the German regional court

<sup>89</sup> Lawrence Collins J also mentioned other grounds that supported the conclusions that there was indeed a sufficient connection between the scheme company and England: i) non-exclusive submission to the jurisdiction of the English courts; ii) associated security documentation governed by English law; iii) collateral package including security granted over English assets; iv) corporate assets situated within the jurisdiction of England; vi) operations or branches of bank creditors in England.

<sup>90</sup> *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2012] BCC 459; *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch), [2013] BCC 201; *Re Seat Pagine Gialle SpA* [2012] EWHC 3686 (Ch); *Re NEF Telecom Company BV* [2012] EWHC 2944 (Comm); *Re Vietnam Shipbuilding Industry Groups* [2013] EWHC 2476 (Ch.); *Cortefiel, SA v Mep II S.A.R.L.* [2012] EWHC 2998 (Ch). See also Lucas Kortmann and Michael Veder, ‘The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?’ (2015) (13)3 Nottingham Insolvency and Business Law e-Journal 239, 245-246.

<sup>91</sup> e.g. *Mauritius Commercial Bank Ltd v Hestia Holdings Ltd & Sujana Universal Industries* [2013] EWHC 1328 (Comm); *Re Apcoa I* [2014] EWHC 1867 (Ch); *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch), [2014] All ER (D) 221 (Nov); *Re DTEK Finance BV* [2015] EWHC 1164 (Ch); *Re TORM AIS* [2015] EWHC 1916 (Ch); *Algeco Scotsman PIK S.A.* [2017] EWHC 2236 (Ch).

<sup>92</sup> even if the governing law was amended last-minute to establish a sufficient connection with England, given the fact that if the applicable law would be fundamental to the contract, changing it would require a supermajority or unanimous consent. However, this is not always the case. In *Re DTEK Finance BV*, the applicable law clauses in the underlying finance documents did not qualify as a ‘reserved matter’ that required a supermajority of 90%, as a result of which a simple majority in value of the noteholders could change the governing law and bind all other noteholders. It should nonetheless be noted that in the said case also other evidence of its ‘sufficient connection’ to England was presented to the court.

<sup>93</sup> See *infra* ‘3.3.2.2 EU Judgments Regulation’ (Part B: English Scheme of Arrangement).

<sup>94</sup> *Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch), §18-19: “If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping. In the particular circumstances of this case, I cannot see that the fact that the company has been acquired only recently, and with a view to invoking the scheme jurisdiction, should cause me, in the exercise of my discretion, to decline to sanction the scheme. For reasons I have already touched on, the scheme appears to be very much in the interests of the group’s creditors.”

<sup>95</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 233. See also considerations of Briggs J in *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch.); [2012] BCC 459, §73-77.

(*Oberlandesgericht Celle*) in the *Equitable Life* case, in which the court refused to recognise the (sanctioned) scheme of insurance company Equitable Life.<sup>96</sup>

In practice, the effectiveness of a scheme is nowadays often demonstrated by the debtor by means of an expert opinion on local law, confirming the recognition of the scheme in the debtor's jurisdiction.<sup>97</sup> If the compromised claims are subject to English law, the scheme is likely to be effective abroad taking into account that private international law rules generally allow contracts that are governed by a foreign law to be altered by that law. Recognition of English schemes abroad will be further elaborated on hereinafter under heading '3.3.3 Recognition Issues'.

### 3.3 European and international law

#### 3.3.1 Background

As already touched upon above, it is important to assess to what extent EU legislation (i) confers jurisdiction on the English courts to sanction schemes in relation to foreign debtors ; and (ii) obliges other Member States and, in particular, the home state of the debtor to give legal effect to an English Scheme.

In this regard, the (recast) European Judgments Regulation (hereinafter 'EJR')<sup>98</sup> and the (recast) European Insolvency Regulation (hereinafter 'EIR')<sup>99</sup> are of crucial importance to the allocation of jurisdiction in proceedings brought within the EU and the mutual recognition and enforcement of judgments across the different Member States. It is important to note that these two regulations are intended to operate side by side and dovetail into one another. According to Payne, the demarcation between the EJR and the EIR is effectively the demarcation between solvency respectively insolvency.<sup>100</sup>

Given the current political climate and, more specifically, the ongoing Brexit negotiations, one may rightly question why these supranational issues would still be relevant in the future, as this legislation might no longer apply to the UK. In the author's opinion, an overview of how courts have addressed jurisdictional and recognition issues in the past may still provide valuable insights.

#### 3.3.2 Jurisdictional Issues

##### 3.3.2.1 *EU Insolvency Regulation*

The (recast) EIR applies to the national insolvency procedures which are exhaustively listed in its Annex A.<sup>101</sup> Albeit the scheme of arrangement is not included in this list and therefore remains in principle unaffected by it, concerns were raised that the above discussed condition of being "*liable to be wound up under the IA 1986*" developed by the English courts<sup>102</sup> would not be fulfilled for companies that do not have their COMI in the UK, as the English courts would not have jurisdiction to

<sup>96</sup> OLG Celle 8 U 46/09, 8 September 2009.

<sup>97</sup> e.g. *Re NEF Telecom Company BV* [2012] EWHC 2944 (Comm.); *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch); [2011] 1 BCLC 555; *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch) [2015] WLR(D) 326.

<sup>98</sup> Regulation (EU) 2015/848 of 20 May 2015 of the European Parliament and of the Council on insolvency proceedings (recast) [2015] OJ L 141, 19–72.

<sup>99</sup> Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 351.

<sup>100</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 308.

<sup>101</sup> (recast) EIR, recital 9.

<sup>102</sup> See *supra* 3.2.1. "Sufficient connection" (Part B: English Scheme of Arrangement).

wind up these companies pursuant to Article 3 EIR.<sup>103</sup> As a consequence, the English courts would also lack jurisdiction to sanction schemes in relation to such companies.

Notwithstanding, it did not stop Lewison J in *Dap Holding* from sanctioning a scheme of a Dutch company without even having an establishment, let alone its COMI in the UK. The underlying reasoning was that a company's COMI is transient and subject to change<sup>104</sup> and should, therefore, not prejudice the English courts' winding-up jurisdiction.<sup>105</sup>

Another, more convincing, argument is that the (recast) EIR simply does not apply to schemes at all, as s.895 CA 2006 was introduced long before the adoption of the EIR - and the EJR<sup>106</sup> - and nothing suggests that the EU legislator intended to (indirectly) restrict the courts' scheme jurisdiction. If that would be the case, then why are schemes left out of Annex A?<sup>107</sup>

In practice, English judges have always held that the EIR has no impact on their jurisdiction to sanction schemes. Hence, this minor 'uncertainty' has not limited the willingness of the courts to sanction foreign schemes.<sup>108</sup> Recent case law indicates that this controversy has been settled and that the courts' jurisdiction is in no way affected by the (recast) EIR.<sup>109</sup>

### 3.3.2.2 *EU Judgments Regulation*

Unlike the EIR, which might only have an indirect impact on the courts' jurisdiction, the (recast) EJR has given rise to questions as to how it *directly* affects the English courts' ability to sanction foreign schemes.

The first landmark case in this respect was *La Mutuelles*, wherein it was decided that the former EJR was wholly inapplicable pursuant to Article 1(2)(b) EJR, which explicitly excludes winding-up proceedings, judicial arrangements, compositions and analogous proceedings from its scope.<sup>110</sup>

In *Rodenstock*, Briggs J rejected this inapplicability of the EJR, ruling that schemes are “*civil and commercial matters*” within the meaning of Article 1 EJR and that the purpose of the aforesaid exclusion is only to demarcate the border with the scope of the EIR.<sup>111</sup>

<sup>103</sup> See Look Chan Ho, 'Making and enforcing international schemes of arrangement' (2011) *Journal of International Banking Law and Regulation*, 435-36.

<sup>104</sup> such as where the company chooses to locate its headquarters, hold its board meetings and operate its bank accounts.

<sup>105</sup> *Dap Holding NV* [2005] EWHC 2092 (Ch), §11 and later confirmed in *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch) [2015] WLR(D) 326, §38.

<sup>106</sup> A similar problem arose in respect of Article 22(2) EJR, currently, Article 24(2) (recast) EJR, which gives exclusive jurisdiction to the competent court of the Member State in which the company has its seat for proceedings with the ‘the dissolution of companies’ as objective, *i.e.* solvent liquidations (as the EIR deals with insolvency). Likewise Article 3 EIR, this provision entails that English courts can only wind up solvent companies with their seat in the UK and, therefore, indirectly prejudices the ‘liable to be wound up’ criterion of s.895(2) CA 2006. The same line of reasoning was adopted in relation to the EJR, especially taken into consideration that solvent schemes were non-existent in the participant-countries to the original Brussels Convention.

<sup>107</sup> See Gabriel Moss QC in *Re Sovereign Marine & General Insurance Co Ltd* [2006] EWHC 1335 (Ch), [2007] 1 BCLC 228, §36-37. This line of reasoning has been recently reiterated by Briggs J in *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch), [2012] BCC 459, §63 and was also confirmed in *Re La Seda de Barcelona SA* [2010] EWHC 1346 (Ch), [2011] 1 BCLC 555 (although in this case the scheme company had an establishment in the UK so it was in fact ‘liable to be wound up’ anyway).

<sup>108</sup> In this regard, see considerations of David Richards J in *Re Seat Pagine Gialle SpA* [2012] EWHC 3686 (Ch).

<sup>109</sup> *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch), §39; *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (Ch), §23; *Re CBR Fashion Holding AG* [2016], unreported, 5 August 2016, as referred to in Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 58; Lucas Kortmann and Michael Veder, ‘The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?’ (2015) (13)3 Nottingham Insolvency and Business Law e-Journal 239, 248.

<sup>110</sup> *Re La Mutuelles du Mans Assurances IARD* [2006] BCC 11.

<sup>111</sup> *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) [2012] BCC 459, [2011] ILPr 34.

The court nonetheless found that there was a lacuna in the EJR because it did not contain any rules regarding schemes. During this case, it was suggested that jurisdiction must be allocated on the basis of defendant's domicile pursuant to Article 2 EJR (currently Article 4 recast EJR).<sup>112</sup> Considering that a scheme procedure in fact does not involve any 'defendants' at all, this reasoning seemed rather far-fetched and artificial.<sup>113</sup>

In the *Primacom* case, it was subsequently held that the residence criterion of Article 2 EJR (currently Article 4 recast EJR) was not applicable to schemes as they are not a conventional type of adversarial proceedings as there are in fact no defendants being sued. Hildyard J further explained that the court nonetheless had jurisdiction on the grounds of either Article 23 EJR (currently Article 25 recast EJR)<sup>114</sup>, because the scheme compromised claims that were contractually subjected to the jurisdiction of the English courts, or Article 24 EJR (currently Article 26 recast EJR)<sup>115</sup>, as the concerned creditors voluntarily appeared before it. The first argument gained importance ever since, being repeatedly confirmed by the English courts.<sup>116</sup>

Somehow breaking with this tradition of 'welcoming' foreign debtors, Snowden J recently held in *Re Van Gansewinkel*<sup>117</sup>, and later in *Re Global Garden Products*<sup>118</sup>, that Article 25 (recast) EJR would not confer jurisdiction on the English Courts in case of a so-called 'one-way' jurisdiction clause for the sole benefit of either the scheme creditors or the company itself. Snowden J held that Article 25 (recast) EJR required that *all* parties involved had contractually submitted themselves to the English courts' jurisdiction.

The (in)applicability of the said article was also raised in the subsequent cases *Re Hibu*<sup>119</sup> and *Re CBR Fashion*<sup>120</sup>, wherein the courts also avoided this issue and accepted – as Snowden J did in the above mentioned cases – jurisdiction on the basis of Article 8 (recast) EJR, which provides that a person domiciled in a EU member state may be sued “*where he is one of a number of defendants, in the courts for the place where any one of them is domiciled, provided that the claims are so closely connected that it is expedient to hear and determine them together.*”

Notwithstanding that in the *Van Gansewinkel* schemes only 15 of over 100 scheme creditors<sup>121</sup> were domiciled in England, Snowden J held that there was no numerical condition and a court would have jurisdiction ex Article 8 (recast) EJR, if at least one scheme creditor is domiciled in the UK and it is expedient to hear the claims against all other scheme creditors at the same time. Snowden J subsequently affirmed this stance in *Re Global Garden Products* and reiterated *Re Metinvest BV*<sup>122</sup> with regard to the 'expediency' question, answering it in the affirmative “*because of the desirability of*

<sup>112</sup> Article 2 EJR: “*Subject to this Regulation, persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State.*”

<sup>113</sup> It has been alleged that the creditors affected by the scheme should be regarded as 'defendants' for this purpose. This would be on the basis that they have the right to appear and oppose the scheme at the sanctioning hearing and, for that purpose, to serve evidence and make submissions like ordinary defendants. In *Rodenstock* the court found that it did not have to deal with this question, because half of the company's creditors by value were UK residents.

<sup>114</sup> Currently, Article 25(1) EJR: “*If the parties, regardless of their domicile, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction, unless the agreement is null and void as to its substantive validity under the law of that Member State.*”

<sup>115</sup> Currently, Article 26(1) EJR: “*Apart from jurisdiction derived from other provisions of this Regulation, a court of a Member State before which a defendant enters an appearance shall have jurisdiction.*”

<sup>116</sup> *Primacom Holding GmbH & Anor v A Group of the Senior Lenders & Credit Agricole* [2012] EWHC 164 (Ch); ; *Re NEF Telecom Co BV* [2012] EWHC 2944 (Comm); *Re Seat Pagine Gialle SpA* [2012] EWHC 3686 (Ch), §13; *Re Vietnam Shipbuilding Industry Groups* [2013] EWHC 2476 (Ch);, *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch). *Re Public Joint-Stock Company Commercial Bank “Privatbank” and in the Matter of the Companies Act 2006* [2015] EWHC 3299 (Ch).

<sup>117</sup> *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch), §46-49.

<sup>118</sup> *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (Ch), §31-32.

<sup>119</sup> *Re Hibu Group Ltd* [2016] EWHC 1921 (Ch).

<sup>120</sup> *Re CBR Fashion Holding AG*, unreported, 5 August 2016.

<sup>121</sup> with a total claim value of merely 135 million EUR out of 820 million EUR scheme debt in total.

<sup>122</sup> *Re Metinvest BV* [2016] EWHC 79, §33.

*binding all scheme creditors to the same restructuring*".<sup>123</sup> Nonetheless, Snowden J also emphasized the importance for overseas companies to show an actual connection with the UK and insisted on more evidence of the domicile and identity of the scheme creditors.<sup>124</sup>

Conclusively, up to now the English courts have been able to sanction schemes on different inconsistent and, above all, far from bulletproof grounds, without addressing vital questions raised with regard to the courts' jurisdiction to bind creditors domiciled in other EU Member States.<sup>125</sup> In addition, it is clear from the recent case law that the jurisdiction of the English courts has come under renewed judicial scrutiny.<sup>126</sup> It remains to be seen what the impact of these latest decisions will be on foreign scheme applications and the scheme's attractiveness among non-UK debtors.

### 3.3.3 Recognition Issues

The issue of recognition is particularly relevant to foreign debtors using English schemes, as there is always a threat of dissentient creditors challenging the scheme before their own local courts. Additionally, if a scheme will not be given legal effect in the debtor's domestic jurisdiction, the English courts are unlikely to assert scheme jurisdiction.<sup>127</sup>

#### 3.3.3.1 *EU Insolvency Regulation*

It is clear from the above that schemes of arrangement do not fall within the ambit of the EIR due to their absence in Annex A.<sup>128</sup> Hence, schemes generally do not enjoy automatic recognition in other EU Member States under Article 32 (recast) EIR. However, if a scheme is sanctioned in the course of an insolvency procedure listed in Annex A, it might nonetheless qualify as a "*composition approved by that court*" within the meaning of Article 32 (recast) EIR and enjoy automatic recognition.<sup>129</sup> In this regard, it is not uncommon for a scheme to be twinned with a (pre-pack) administration.

#### 3.3.3.2 *EU Judgments Regulation*

On the assumption that the EJR is applicable to English schemes, Article 36 (recast) EJR<sup>130</sup> will provide for their automatic recognition throughout the EU. Albeit there is no general consensus about whether English schemes qualify as 'judgments' for the purpose of this provision, the wording of Article 2(a) (recast) EJR ("*any judgment [...], whatever the judgment is called*") suggests a wide interpretation of the term 'judgment', including English schemes.<sup>131</sup> This line of reasoning first

<sup>123</sup> *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (Ch), §25.

<sup>124</sup> *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (Ch), §27 et seq.

<sup>125</sup> Lucas Kortmann and Michael Veder, 'The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?' (2015) (13)3 Nottingham Insolvency and Business Law e-Journal 239, 250.

<sup>126</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 58.

<sup>127</sup> See *supra* '3.2.2 Overseas Effectiveness' (Part B: English Scheme of Arrangement).

<sup>128</sup> See *supra* '3.3.2.1 EU Insolvency Regulation' (Part B: English Scheme of Arrangement).

<sup>129</sup> The argument is premised on the basis that, if a company is placed into administration (a procedure that is recognised under the EIR) prior to a scheme in respect of that company subsequently being sanctioned, the scheme amounts to a composition approved by the court within the ambit of the administration proceedings for the purposes of article 25 EIR and thereby should enjoy automatic recognition within EU member states. However it is worth noting that this argument has received little judicial consideration to date.

<sup>130</sup> currently, Article 36 EJR: "a judgment given in a Member State shall be recognised in the other Member States without any special procedure being required."

<sup>131</sup> This was one of the factors, which weighed heavily with the German Bundesgerichtshof when it considered this issue in 2012. See BGH, IV ZR 194/09, 15 February 2012, para §24 (*obiter dictum*). See also Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 309.

advocated in *Rodenstock*<sup>132</sup> is however not generally accepted. In fact, there is still uncertainty about whether schemes are ‘judgments’ for the purpose of the (recast) EJR.<sup>133</sup>

In the past, national courts of EU Member States in which recognition was sought have not always regarded schemes as ‘judgments’ within the sense of the (recast) EJR. In the *Equitable life* case of 2009, the German regional court (*Oberlandsgericht*) of Celle refused to recognise the scheme of the life insurance company Equitable Life under the EJR on two grounds.<sup>134</sup>

First, the court ruled that an English scheme could not be regarded as a ‘judgment’ in the sense of the EJR due to a lack of ‘adversarial’ nature. However, the German Supreme Court (*Bundesgerichtshof*) overruled this decision in 2012 and stated that the presence of adversarial proceedings is not in itself necessary and that the right for parties to be heard suffices.<sup>135</sup>

Secondly, the German regional court held that a ‘judgment’ for this purpose must “emanate from a judicial body of a Contracting State deciding on its own authority on the issues between the parties.”<sup>136</sup> In this regard, it regarded schemes to be homologated settlements rather than judgments due to the fact that they depend on the parties’ intention and not on judicial authority.<sup>137</sup> This reasoning was also not followed by the German Supreme Court.<sup>138</sup>

In addition, it might be worth noting here that regardless of the fundamental issues discussed above, the homologation of a scheme constitutes, at least formally speaking, a ‘judgment’ according to English Law. Having regard to Article 45 (recast) EJR, which in fact prevents the court of the jurisdiction where recognition is sought to review the jurisdiction of the court who rendered the judgment, except on limited grounds (e.g. overriding public policy reasons), it can be argued that recognition under the (recast) EJR might be more solid than expected based on the above considerations.<sup>139</sup>

However, the *Equitable Life* case shows that foreign debtors cannot carefree draw upon the overseas effectiveness of English schemes under the umbrella of the (recast) EJR.<sup>140</sup> This is ultimately an issue for the European Court of Justice to decide.

<sup>132</sup> *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) [2012] BCC 459.

<sup>133</sup> Therefore, when presenting evidence of the effectiveness of the scheme in its home state in order to convince the English High Court to assume jurisdiction (see *supra* ‘3.2.2 Overseas Effectiveness’), the expert opinion provided by the debtor will often be two-fold and demonstrate the scheme’s effectiveness both based on the premise that the EJR applies, as well as assuming that the EJR is wholly inapplicable (e.g. in *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch), Prof. Dr. P.M. Veder on Dutch law and Prof. Dr. Geert van Calster on Belgian law agreed that the scheme would be recognised under Article 36 (recast) EJR, if the EJR would apply, and, if not, on the basis of domestic rules of private international law).

<sup>134</sup> OLG Celle 8 U 46/09, 8 September 2009.

<sup>135</sup> BGH, IV ZR 194/09, 15 february 2012. This view was already adopted in Landesgericht Potsdam, 2 O 501/07, 27 January 2011, (Potsdam Regional Court) See also Reinhard Bork, ‘Recognising schemes of arrangements in Germany – back to square one’, (2013) *Insolvency Intelligence* 10.

<sup>136</sup> Case C-414/92 *Solo Kleinmotoren GmbH v Boch* [2008] ECR I-2237, §17-18.

<sup>137</sup> OLG Celle 8 U 46/09, 8 September 2009, §84.

<sup>138</sup> However, the German Supreme Court upheld the 2010 decision of the Oberlandesgericht of Celle and also rejected the recognition of the Equitable Life scheme due to the fact that it related to the compromise of insurance claims held by German insurance holders. Pursuant to the Court, the scheme could therefore not be given legal effect in Germany because insurance matters should be dealt by the courts of the EU Member State in which the relevant creditors are domiciled, regardless of whether the creditors are policyholders, insured or beneficiaries of a company incorporated in another Member State.

<sup>139</sup> In *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch), both Prof. Dr. Veder (the Netherlands) and Prof. Dr. Van Calster (Belgium), as well as Prof. Dr. Vaccarella (Italy) in *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (Ch) shared the view that the domestic courts would not question the assumption of jurisdiction by the English court, as Article 45 (recast) EJR prevents the recognising court from reviewing the jurisdiction of the court of the Member State of origin of the judgment, except on grounds of public policy. When confirming the respective schemes’ effectiveness in their home jurisdiction, the experts held that a scheme of arrangement would not be regarded as manifestly contrary to their country’s public policy. See also Lucas Kortmann and Michael Veder, ‘The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?’ (2015) (13)3 *Nottingham Insolvency and Business Law e-Journal* 239, 258.

<sup>140</sup> See also Sebastian Becker, *Sanierung deutscher Unternehmen durch das englische Scheme of Arrangement* (Norderstedt, Grin Publishing 2012) 20.



### 3.3.3.3 *Rome Convention on Contractual Obligations*

Another potential basis for EU recognition of schemes has been found in the Council Regulation on the law applicable to contractual obligations (hereinafter ‘ROME I’).<sup>141</sup> Article 3(1) ROME I provides that a contract will be governed by the law chosen by the parties and Article 12(1)(d) ROME I dictates that the governing law of the contract should also govern “*the various ways of extinguishing obligations*” in relation to that contract. Hence, it is clear from Article 12 ROME I that contractual claims governed by English law can be validly altered by English law and the procedures available thereunder.

Article 1(2)(f) ROME I, however, explicitly excludes matters “*governed by laws of companies*” from its scope.<sup>142</sup> Although schemes are regulated in the UK Companies Act of 2006 and therefore seem to fall outside the ambit of ROME I, Payne<sup>143</sup> and O’Dea<sup>144</sup> are of the opinion that this exclusion envisages corporate governance matters and does not aim at alterations of contractual rights by means of a creditor scheme.<sup>145</sup> In practice, foreign debtors have in several cases successfully relied on ROME I to underpin the effectiveness of the proposed scheme in their home state.<sup>146</sup>

### 3.3.3.4 *National conflict-of-law rules*

If none of the above supranational instruments are found applicable, national conflict-of-law rules will come into play. In most jurisdictions, private international law rules generally allow agreements governed by a foreign law to be altered in accordance with the (procedural) rules of that law.<sup>147</sup> Accordingly, a company enforcing an English scheme will rarely face any problems when the compromised claims stem from contracts governed by English law.<sup>148</sup>

In the particular case of Spanish companies,<sup>149</sup> it has been repeatedly argued before the English courts that a scheme of arrangement will be given effect in Spain, if the claims compromised thereunder are governed by English law.<sup>150</sup> For instance in *La Seda*<sup>151</sup>, the expert opinions presented to the English court indicated that the scheme would be regarded as an amendment of creditors’ rights under the

<sup>141</sup> Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (ROME I) [2008] OJ L 177, 6–16.

<sup>142</sup> “*such as the creation, by registration or otherwise, legal capacity, internal organisation or winding-up of companies and other bodies corporate and unincorporated, and the personal liability of officers and members as such for the obligation of the company or body*” (Article 1(2)(f) ROME I)

<sup>143</sup> Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 309.

<sup>144</sup> Geoff O’Dea, Julian Long and Alexandra Smyth, *Schemes of arrangement: law and practice* (Oxford, OUP 2012) 19.

<sup>145</sup> For an opposing view, see Lucas Kortmann and Michael Veder, ‘The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?’ (2015) (13)3 Nottingham Insolvency and Business Law e-Journal 239, 254.

<sup>146</sup> e.g. *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) [2012] BCC 459; *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch.) [2013] BCC 201 and - in relation to Spain - *Re Metrovacesa SA* [2011] EWHC 1014 (Ch).

<sup>147</sup> Under the widely recognised principle of reciprocity (*i.e.* practice among states or courts of different jurisdictions, involving the mutual recognition of legislative, executive, and judicial acts), national should endorse expressly agreed choice-of-law clauses, which entails that amendments to an agreement governed by a particular law made in accordance with that law should be given legal effect. See also Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 307; Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 162.

<sup>148</sup> See for example the expert opinions of professor dr. M. Veder (Netherlands) and professor dr. G. Van Calster (Belgium) in *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch) [2015] WLR(D) 326.

<sup>149</sup> A number of schemes have been sanctioned by the English courts in relation to Spanish companies. Notable cases are *La Seda De Barcelona*, *Metrovacesa*, *Cortefiel* and *Orizonia*. See *infra* ‘2.2.2 Forum shopping for English Schemes’ (Part C: Corporate Rescue in Spain).

<sup>150</sup> The above, however, might not apply when the compromise adopted through the scheme is not limited to a rescheduling of debt but also to corporate structural modifications such as mergers or spin-offs. In this situation dissenting creditors will in principle be protected by company law mechanisms set forth by the Spanish law.

<sup>151</sup> *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

company's bank facility agreements, and because this amendment would be binding under the governing law of the facility agreements (*i.e.* English law), the scheme would be recognized under the laws of Spain.<sup>152</sup> This view was subsequently confirmed when the Spanish real estate group Metrovacesa applied for a scheme of arrangement.<sup>153</sup>

Nonetheless, it remains doubtful whether an English scheme would be recognised in Spain, if the claims included in the scheme are governed by a law other than English law.

### 3.4 Brexit

#### 3.4.1 Impact

Needless to say, Brexit will have an impact on the recognition of schemes in the EU. The UK leaving the EU, in whatever form, will certainly have consequences for the popularity of the English scheme and the English restructuring market as a whole. However, it is important to note that the leave vote does not immediately change everything what has been discussed above in terms of jurisdiction and recognition of schemes in the EU.<sup>154</sup> The UK will remain a Member State until it reaches an agreement with the EU with regard to the concrete execution of its withdrawal or until the two-year transitional period of Article 50 TEU expires (*i.e.* 29 March 2019).<sup>155</sup> Therefore, the factual correctness of the assumptions made hereinafter will strongly depend on which *post*-Brexit model is negotiated.

However, *prima facie* it appears that the leave vote is unlikely to prejudice the English schemes' usefulness for foreign companies, considering that it has already overcome recognition issues in the past and has often been accepted by foreign courts on the basis of their national conflict-of-law rules.<sup>156</sup> Be that as it may, the uncertainty caused by Brexit may nonetheless move companies to turn to other European restructuring procedures.

#### 3.4.2 Type of Brexit

Whilst the UK may try to cling to the advantages the European single market offers, it appears to be unlikely that the Member States would be willing to agree to such *post*-Brexit scenario. The Member States will simply have no interest whatsoever in maintaining the UK's strong position in the economic and judicial market. On the contrary, they might in turn attempt to lure big market players and attract high-profile commercial litigation (*i.e.* regulatory competition).<sup>157</sup>

If, however, the UK becomes part of the EFTA<sup>158</sup> and, therefore, the Lugano Convention of 2007<sup>159</sup>, a regime similar to the one of the EJR will apply in respect of the jurisdiction, recognition and

<sup>152</sup> Michael Rutstein, 'Roll up! Roll up! Schemes round-up: foreign companies are coming to England to benefit from the scheme of arrangement process.' (2011) 4(4) Corporate Rescue and Insolvency 125.

<sup>153</sup> *Re Metrovacesa SA* [2011] EWHC 1014 (Ch). In this case, it was also held that the Spanish courts were likely to give effect to English schemes as a matter of public policy as Spain was in the process of introducing its own scheme procedure ('Homologacion Judicial') at that time.

<sup>154</sup> EU-derived law (e.g. transposition of EU directives) in the UK will in any case remain in tact.

<sup>155</sup> *i.e.* 29 March 2019.

<sup>156</sup> See *supra* '3.3.3.4 National conflict-of-law rules' (Part B: English Scheme of Arrangement).

<sup>157</sup> Regulatory competition is the phenomenon in law, economics and politics concerning the desire of law makers to compete with one another in the kinds of law offered in order to attract businesses or other actors to operate in their jurisdiction. On different forms of regulatory competition in contract law and dispute resolution, see Horst Eidenmüller (ed.), *Regulatory Competition in Contract Law and Dispute Resolution* (Munich: C. H. Beck, 2013), 1-10.

<sup>158</sup> The European Free Trade Association is a regional trade organization and free trade area consisting of four European states: Iceland, Liechtenstein, Norway, and Switzerland.

<sup>159</sup> Convention of 30 October 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2007] OJ L 339, 3-41.

enforceability of judicial decisions between the UK and the EU. Alternatively, the UK could become a member to the Hague Convention on the Choice of Court Agreements of 2005, which also provides a uniform set of rules regarding jurisdiction and recognition of foreign judgments. Nonetheless, as this article will explain subsequently, these international conventions are not able to fully guarantee the overseas effectiveness of schemes.

### 3.4.3 Consequences

#### 3.4.3.1 *Jurisdiction of the English Courts*

Given the fact that both the (recast) EIR and the (recast) EJR will no longer have any influence on the jurisdiction of the English courts to sanction a scheme in relation to foreign companies, one could argue that Brexit will smoothen foreign scheme applications rather than jeopardize them.<sup>160</sup> However, as discussed above, English courts will only exercise their discretion to sanction a scheme, if sufficient evidence of its effectiveness in the debtor's home state has presented.<sup>161</sup> This requirement entails that Brexit may, however, still jeopardize the sanction of foreign schemes, as recognition in the EU will even become more uncertain.

#### 3.4.3.2 *Effectiveness in the EU*

First, schemes of arrangement are not listed in Annex A to the (recast) EIR. In other words, schemes *an sich* have never and will never benefit from automatic recognition under EU insolvency legislation. Hence, the fact that the (recast) EIR will no longer apply to the UK will have little or no impact on the overseas effectiveness of English schemes.

On the other hand, Brexit might also mean that schemes will no longer benefit from the free movement of judgments under the EJR.<sup>162</sup> Albeit it is controversial whether the EJR technically applies to schemes at all, foreign debtors have not rarely relied on it for the purpose of recognition of their scheme outside the UK.<sup>163</sup> If this is no longer possible *post*-Brexit, the recognition of schemes will most likely be based on private international law<sup>164</sup> or, occasionally, on the ROME I Regulation<sup>165</sup>. As mentioned earlier, private international law as recognition basis might prove more challenging and less of a uniform approach.

Becoming a party to the Lugano Convention of 2007<sup>166</sup> might resolve the empty space the (recast) EJR will leave behind. Albeit it contains similar provisions in relation to recognition and enforcement of judgments among EU and EFTA Members, it has one major drawback compared to the EJR: for a judgment to be enforceable in another country, a national exequatur will still be required. Intermediate proceedings before national courts will be necessary to obtain such an enforceable title, which might result in a stricter judicial review and extra costs and delay.

<sup>160</sup> Jennifer Marshall, Joel Ferguson and Lucy Aconley, 'Brexit: what next for cross-border restructurings and insolvencies?' (2016) *Corporate Rescue and Insolvency* 149, 150.

<sup>161</sup> See *supra* '3.2.2 Overseas Effectiveness' (Part B: English Scheme of Arrangement).

<sup>162</sup> *i.e.* recognition and enforcement of judgments in other EU Member States without the need for an exequatur or any other intermediate intervention of local courts.

<sup>163</sup> *e.g.* BGH, IV ZR 194/09, 15 February 2012, §24 (*obiter dictum*). See also Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 309.

<sup>164</sup> *e.g.* *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch) [2015] WLR(D) 326 and - in relation to Spain - *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch) and *Re Metrovacesa SA* [2011] EWHC 1014 (Ch).

<sup>165</sup> *e.g.* *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch) [2012] BCC 459; *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch.) [2013] BCC 201 and - in relation to Spain - *Re Metrovacesa SA* [2011] EWHC 1014 (Ch).

<sup>166</sup> to which the UK is currently a party, being a Member State of the EU.

Finally, with regard to the application of ROME I, special attention should be given to schemes affecting contractual obligations explicitly governed by English law.<sup>167</sup> ROME I requires Member States to give full effect to party autonomy on choice of law and is not conditioned on (continued) membership in the EU.<sup>168</sup> Hence, regardless of the fact that the UK might no longer be a party to ROME I, the Member States will nevertheless have to sustain choice-of-law clauses and jurisdiction clauses in respect of third party states. In other words, ROME I would apply in essentially the same way to contracts governed by English law after Brexit.

#### 3.4.4. Conclusion

In conclusion, the impact of Brexit on the 'availability' of English schemes to foreign companies might not be significant, given the fact that the scheme of arrangement as such was never included in the EU's insolvency framework in the first place. It could even be argued that the forthcoming inapplicability of certain EU instruments may grease the wheels of English courts when asserting scheme jurisdiction. Therefore, the author believes that foreign scheme applications will remain largely unaffected by Brexit on the level of jurisdiction of the English courts.

The potential negative consequences of Brexit are situated on the level of recognition. Issues may arise when the scheming company wants to enforce its scheme on EU territory. Without being able to benefit from the free movement of judgments under the EJR, recognition will likely have to be sought in national conflict-of-law rules or the provisions of ROME I. This is of course burdensome in itself, as discussed above, but it may also jeopardize the willingness of English courts to exercise jurisdiction.

In the author's opinion, these repercussions should not be exaggerated.<sup>169</sup> First of all, expert evidence indicates that the EU Member States' domestic rules of private international law are generally quite acceptable towards English schemes, especially if the creditor rights affected by it are governed by English law (e.g. in the Netherlands, Belgium and Spain).<sup>170</sup> Secondly, ROME I ensures that EU Member States respect the parties' autonomy on choice of law in contracts

It is yet to be seen whether the aforesaid burdens and risks associated with Brexit will prompt companies to turn to restructuring tools other than the English scheme and whether, for instance, large Spanish enterprise groups will start using the new pre-insolvency procedures that have recently been enacted in their home country.

<sup>167</sup> See for instance *Re Rodenstock GmbH* [2011] EWHC 1104 (Ch); [2012] BCC 459; *Re Primacom Holding GmbH* [2012] EWHC 164 (Ch); [2013] BCC 201.

<sup>168</sup> Matthias Lehmann and Nihal D'Souza, 'What Brexit means for the interpretation and drafting of financial contracts' (2017) 32(2) JIBFL101, 103.

<sup>169</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 163.

<sup>170</sup> See for example the expert opinions of professor dr. M. Veder (Netherlands) and professor dr. G. Van Calster (Belgium) in *Re Van Gansewinkel Groep BV & Ors* [2015] EWHC 2151 (Ch) [2015] WLR(D) 326 and - in relation to Spanish companies - *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch) and *Re Metrovacesa SA* [2011] EWHC 1014 (Ch); Jennifer Payne, *Schemes of Arrangement. Theory, Structure and Operation* (Cambridge University Press 2014) 307; Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 162; Lucas Kortmann and Michael Veder, 'The Uneasy Case for Schemes of Arrangement under English Law in Relation to non-UK Companies in Financial Distress: Pushing the Envelope?' (2015) (13)3 Nottingham Insolvency and Business Law e-Journal 239, 259.

## C. CORPORATE RESCUE IN SPAIN

### §1. The Spanish Insolvency Act (*Ley Concursal* 22/2003)

#### 1.1 Background

The entry into force of the Spanish Insolvency Act or *Ley Concursal* (hereinafter ‘LC’) on 1 September 2004 ended an era of inefficient, fragmented and above all outdated insolvency legislation.<sup>171</sup> The Spanish insolvency law framework used to consist of a number of archaic commercial and civil law statutes from the 19<sup>th</sup> and 20<sup>th</sup> century.<sup>172</sup>

The old regime made a sharp distinction between insolvency procedures for commercial debtors and non-commercial debtors, respectively the *quiebra* (bankruptcy) and the *concurso de acreedores* (creditors’ meeting).<sup>173</sup> Considering its personal scope (i.e. non-commercial creditors), the latter procedure is not of great interest to this study.

The Spanish *quiebra* proceedings could be initiated by the debtor himself or his creditors and gave rise to a management displacement by creditor-appointed representatives, who then subsequently liquidated the company’s assets and paid off the creditors with the proceeds. Albeit this procedure also allowed financially troubled companies to restructure, the rules were very rough on the debtor and the process was long, complex and costly, which made restructuring under this procedure practically impossible.<sup>174</sup> Notwithstanding, Spain’s outdated insolvency framework also provided for several pre-insolvency tools, such as the *suspensión de pagos* (suspension of payments), the *quita* (discharge of debts) and the *espera* (stay of payments).<sup>175</sup>

The suspension of payments procedure, i.e. the only pre-insolvency tool available to commercial debtors at that time, was commonly used by Spanish companies to restructure their debt. This procedure could only be commenced by the debtor and allowed the existing management to retain control of the business. Although less complex than the *quiebra* proceedings, the suspension of payments procedure was also too rigid to be able to speak of an effective restructuring procedure.<sup>176</sup> Conclusively, the procedures available to corporate debtors were unable to cope with the needs of a

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<sup>171</sup> Ley 22/2003, de 9 de julio, Concursal, BOE no. 164, de 10 de julio de 2003.

<sup>172</sup> (i) the Commercial Code 1829 (covering a number of substantive matters of the bankruptcy procedure); (ii) the Civil Procedural Rules 1881 (containing the main procedural rules governing the bankruptcy procedure); (iii) the Commercial Code 1885 (laying down the legal regime of bankrupt debtors); (iv) the Civil Code 1889 (regulating the two procedures applicable to the situations of civil debtors in temporary financial distress or terminal insolvency); and (v) the Suspension of Payments Law 1922 (establishing the legal regulation of suspension of payments procedures). See also Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, ‘Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?’ (2009) 6(4) *International Corporate Rescue* 213, 213.

<sup>173</sup> Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, ‘Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?’ (2009) 6(4) *International Corporate Rescue* 213, 213.

<sup>174</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, ‘The Spanish Business Bankruptcy Puzzle’ (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE\\_.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE_.pdf)> accessed 15 February 2019.

<sup>175</sup> *quita* and *espera* were only available to non-commercial debtors.

<sup>176</sup> This is not very surprising, given the fact that the original Law on Suspension of Payments of 26 July 1922 was initially considered to be just a temporary solution. Nonetheless, as comprehensive reforms stayed out, this provisional law became a central pillar of the Spanish insolvency system (Blanca Manzano López and Juliana Reyes Berón, ‘The Reform of the Spanish Insolvency Law: Proposal No 101-1 of 23 July 2002’ (International Bar Association (IBA) Conference, San Francisco, 14-19 September 2003) <<https://www.iiglobal.org/sites/default/files/SpainIntlInsLawPaper.pdf>> accessed 15 February 2019). See also Marco Celentani, Miguel García-Posada and Fernando Gómez, ‘The Spanish Business Bankruptcy Puzzle’ (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE\\_.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE_.pdf)> accessed 15 February 2019.

modern economy.<sup>177</sup>

Eventually in June 2002, after decades of being a high priority on Spain's legislative agenda,<sup>178</sup> the Spanish parliament issued a proposal for a consolidated insolvency act: The '*Ley Concursal*'. This new law introduced significant substantive and procedural changes to the old bankruptcy rules in order to align Spain's insolvency legislation with the economic reality.<sup>179</sup> Following the World Bank's recommendation<sup>180</sup> that "*each insolvency system must be complementary to, and compatible with, the legal system of the society in which it is rooted and whose value system it must ultimately sustain*", the Spanish legislator did not envisage to break with its national tradition in the field of insolvency law. This reform rather intended to improve the system by streamlining the available insolvency procedures with both national and supranational<sup>181</sup> developments in insolvency law at that time.<sup>182</sup>

## 1.2 Modernisation and Simplification

### 1.2.1 New Objective

Generally speaking, the LC has two primordial aims. First, it traditionally strives for the full repayment of creditors through procedures facilitating an orderly and collective execution against the debtor's assets.<sup>183</sup> Secondly, with the enactment of the LC, Spain's insolvency law now also takes business continuity and corporate rescue to heart.<sup>184</sup> A good example of this new mentality is the introduction of the concept of 'imminent' next to 'actual' insolvency in Article 2.3 LC, which is an unprecedented development in the country's legal tradition borrowed from German law.<sup>185</sup> It enables a financially struggling company to anticipate the inability to meet its financial obligations in the near future and file earlier for insolvency proceedings.<sup>186</sup>

### 1.2.2 One Single Procedure: '*Concurso*'

The LC abolished the former dual regime with its outdated procedures and introduced a single

<sup>177</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019.

<sup>178</sup> The first attempt to radically reshape Spain's insolvency legislation was made in 1959. Later, the global recession in the early 1980s forced legislators all over the world to adopt insolvency rules that were able to effectively deal with the severe economic problems it gave rise to. On June 27, 1983 the new Draft of the Insolvency Law, a far-reaching project of insolvency reform, was proposed but failed, as well as the more recent proposal made in 1995 and 2001, either due to political issues or an unsupportive economic opinion in Spain at that time. See also Rafael Garcia Villaverde, Alberto Alonso Ureba and Juana Pulagar Ezquerro (eds), *Estudios sobre el Anteproyecto de Ley Concursal de 2001* (Editorial Dilex, 2002).

<sup>179</sup> Preamble to the Proposal of Spanish Insolvency Law No 101-1 available at [www.congreso.es](http://www.congreso.es).

<sup>180</sup> World Bank, *Effective Insolvency Systems; Principles and Guidelines* (October 2012) 11.

<sup>181</sup> cf. EC Regulation No 1346/2000 on insolvency proceedings.

<sup>182</sup> Exposición de Motivos, I, d), de Ley 22/2003, de 9 de julio, Concursal. See also Marie-Louise Nauta and Frederiek Bulten, 'Introduction to Spanish Cross-Border Insolvency Law – An Adequate Connection with Existing International Insolvency Legislation' (2009) 18 International Insolvency Review 59-76.

<sup>183</sup> Exposición de Motivos, II, de Ley 22/2003, de 9 de julio, Concursal. See also Antonio Fernandez, 'Another Step' (2010) 94 *European Lawyer* 7.

<sup>184</sup> Exposición de Motivos, VII, de Ley 22/2003, de 9 de julio, Concursal.

Interesting to note here is that, although the Act's Preamble suggests that the desirability of keeping viable businesses in the market was the key consideration of the Spanish policy makers at the time of drafting the *Ley Concursal*, some legal scholars still believe that the traditional objective, i.e. repayment of creditors by means of collectively and orderly executing against the debtor's assets, remains the primordial objective of the *concurso* process and undermines this pursuit of business continuity. See for instance Antonio Fernandez, 'Another Step' (2010) 94 *European Lawyer* 7.

<sup>185</sup> Antonio Fernandez, 'Another Step' (2010) 94 *European Lawyer* 7.

<sup>186</sup> Exposición de Motivos, II, de Ley 22/2003, de 9 de julio, Concursal. The author believes that in order to preserve economically viable companies, financial difficulties should be tackled as early as possible to avoid severe impairment of the debtor's assets and maintain a realistic chance of corporate recovery.

insolvency procedure (*concurso*) for both companies and individuals.<sup>187</sup> This new procedure primarily attempts to facilitate corporate recovery by means of a compromise between a debtor and its creditors (*convenio*). Only if no agreement on the company's reorganisation can be achieved, the company will enter into liquidation.

Both the debtor (voluntary filing) and its creditors (compulsory filing)<sup>188</sup> may initiate proceedings if the debtor cannot pay its liabilities when they fall due.<sup>189</sup> However, actual insolvency is no longer necessary for debtors to be eligible to file for *concurso* proceedings (*cf.* Art. 2.3 LC). Other sticks and carrots for directors to act proactively are (i) the risk of personal liability for late filing for insolvency<sup>190</sup> and (ii) the directors' displacement by court-appointed representatives in the event of a compulsory filing on the creditors' initiative.<sup>191</sup>

After the acceptance of the insolvency petitioning<sup>192</sup>, the court opens the formal procedure by issuing a 'declaration of insolvency'<sup>193</sup>, which gives rise to an automatic stay of enforcement in order to allow the debtor enough time to negotiate an arrangement with its creditors.<sup>194</sup> Subsequently, lawyers, economists and other parties appointed by the court will assess the economic and financial situation of the company. On the basis of their findings the Court will determine whether the debtor is eligible for reorganisation (*convenio*) or whether liquidation is inevitable. If the court believes in the viability of the business, the debtor will start negotiating with its creditors on the terms of each agreement. If not, the company goes straight into liquidation and its assets will be sold piecemeal to repay its creditors to the largest extent possible.

This new unified procedure has significantly reduced the length and the costs of insolvency proceedings in Spain. Under the former system, debtors often spend more than 5 years in the *quiebra*

<sup>187</sup> For the sake of completion, it should be mentioned that the *Ley Concursal* also introduced a 'fast track procedure' for small companies that meet rigid criteria: less than 50 creditors, assets not above € 5,000,000, etc. The initial LC set that the firm must have simplified accounts and no audited books and the liabilities could initially not exceed €1,000,000, which was adjusted to €10,000,000 by the Royal Decree Law 3/2009 to cope with the increased number of filings after the economic recession (Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019).

<sup>188</sup> Article 22.1 LC: "The insolvency proceedings shall be considered voluntary when the first of the petitions submitted was that by the debtor himself. In the other cases, the insolvency shall be considered compulsory."

<sup>189</sup> Article 2.2 LC: "The debtor is in a state of insolvency if he is unable to meet his obligations that are due on a regular basis."

<sup>190</sup> Pursuant to Article 5.1 LC, Spanish directors have a duty to file within two months from the moment that the company reaches the state of insolvency.

<sup>191</sup> Voluntary filing by the debtor will normally leave the existing management in control and the court-appointed administrators will have a rather marginal supervisory task. At first sight, these incentives seem to be effective as 87% of all bankruptcy filings since the entry into force of the Spanish Insolvency Act in 2004 have been voluntary filings or, in other words, insolvency petitions on the debtor's initiative (see Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019).

<sup>192</sup> Roughly 19% of petitions are rejected, to a higher degree when the petition is not voluntary on the debtor's side. In case of creditor's initiative, opposed by the debtor, typically because insolvency is not convincingly shown. In the case of debtor's initiative, it is essentially because some of the formal requirements are missing or defective, possibly on purpose, when the debtor may try to hastily fulfill the duty to file, or get a head start in petition over creditors. Specifically, 17.6 % for voluntary filings, 30.4% for necessary filings (Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019).

<sup>193</sup> This 'declaration of insolvency' is merely an order stating that the formal proceedings have been opened and that the documented evidence filed with the insolvency petition confirms the alleged state of actual or imminent technical insolvency (Article 14.1 LC).

<sup>194</sup> The enforcement of security over assets or rights necessary for the running of the business or linked to the business or the professional activities is prohibited until the earlier of an arrangement being reached, the company going into liquidation or one year elapsing. Unfortunately, the Spanish Insolvency Act has not clearly defined "assets or rights necessary for the running of the business or linked to the business or the professional activities". Hence, the stay of enforcement actions in relation to these assets and rights is subject to a case-specific appreciation by the insolvency administrator or the Court.

procedure, whereas the LC has been successful in curtailing the average time spent in *concurso* proceedings to less than 2 years.<sup>195</sup>

### 1.2.3 Law 8/2003: Commercial Courts

Needless to say, this new debtor-friendly set of rules can only achieve its rescue objective, if the different actors in the insolvency process have the proper business expertise to adequately assess the economic situation of a struggling business.<sup>196</sup>

Until the year 2003, the Spanish legislator neglected this need for business expertise and assigned bankruptcy cases – some of which were utterly complex – to courts that handled all kinds of disputes ranging from family matters to the most sophisticated corporate lawsuits.<sup>197</sup> Along with the adoption of the LC, Spain eventually enacted the Act 8/2003 of July 9 on the Reform of Insolvency Proceedings, designating specialized Commercial Courts (*Juzgados de lo Mercantil*) to handle business issues such as bankruptcy.<sup>198</sup>

Although at first this new insolvency framework seemed to deliver on its promises given that the recovery rate of Spanish bankruptcies rose to 83 cents on the euro,<sup>199</sup> it revealed its limitations and weaknesses (inexperienced judges, poor infrastructure, etc.) soon after and failed horribly when the credit crunch hit in 2008.<sup>200</sup>

<sup>195</sup> Jesus Almoguera, 'Brief Analysis of the New Spanish Insolvency Code' (2005) 2(4) International Corporate Rescue 179.

<sup>196</sup> Kenneth Ayotte and Hayong Yun, 'Matching Bankruptcy Laws to Legal Environments' (2007) 25(1) Journal of Law, Economics, & Organization 1.

<sup>197</sup> See also Maria-del-mar Camacho-Minano, David Pascual-Ezama and Elena Urquia-Grande, 'On the Efficiency of Bankruptcy Law: Empirical Evidence in Spain' (2013) 22 International Insolvency Review 171, 175.

<sup>198</sup> See also Maria Rodríguez San Vicente, 'Los Juzgados de lo Mercantil' in Rafael García-Villaverde, Alberto Alonso Ureba and Juana Pulgar (eds), *Derecho Concursal* (Madrid, DILEX 2003); Luis Díez Picazo, 'Los Juzgados de lo Mercantil' in A. Rojo et al., *La Reforma de la Legislación Concursal* (Marcial Pons, Madrid 2003).

<sup>199</sup> Rafael Sebastián, 'The Spanish Insolvency Act: A Critical Evaluation' in Katarzyna Gromek Broc and Rebecca Parry (eds), *Corporate Rescue* (Kluwer Law International 2006) 319, 320.

<sup>200</sup> Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, 'Amendment to the Spanish Insolvency Law: Will it Pass the *Acid Test*?' (2009) 6(4) International Corporate Rescue 213, 213; Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 European Company and Financial Law Review 516, 518.



## 1.3 A Failed System

### 1.3.1 Inefficiency Statistics

An interesting finding regarding the effects of the LC in practice is the number of liquidations in proportion to the – by the LC heavily promoted – composition agreements. After all, corporate rescue and the survival of players in the market was alleged to become the main objective of insolvency proceedings under the LC.<sup>201</sup>

However, statistical evidence shows that the LC produced the exact opposite of what it intended to achieve. According to recent data of the National Statistics Institute of Spain, around 94% of the companies filing for *concurso* proceedings end up in liquidation<sup>202</sup> and the average recovery rate for creditors only amounts to 56%.<sup>203</sup> Hence, the LC seems to have failed both in compensating creditors as well as in preserving business continuity.

### 1.3.2 Obstacles to Rescue

Different reasons have been brought forward to explain the LC's failure and, in particular, the great aversion towards *concurso* proceedings among Spanish managers. Hereinafter the most frequent reasons will be discussed in order to better understand the *concurso*'s unattractiveness.

#### 1.3.2.1 Punitive Personal Insolvency

Personal insolvency legislation is often thought to have a considerable impact on corporate bankruptcies. Company directors will assess the potential risks they might face personally in case the company would go bankrupt, when making strategic decisions concerning the fate of the business. Especially in Spain, where the personal insolvency rules did long not provide for a debt discharge.<sup>204</sup>

In addition, Spanish legislation offers judges much discretion to pierce the corporate veil and hold directors personally liable for losses in case they are found guilty of causing/worsening the insolvency situation.<sup>205</sup> Therefore, Spanish directors are generally speaking reluctant to file for *concurso*.

#### 1.3.2.2 Stigma

The Spanish entrepreneurial culture is seriously concerned with the 'stigma' of formal proceedings being opened.<sup>206</sup> Negative preconceptions about insolvency stemming from the *pre-LC* period are

<sup>201</sup> See *supra* '1.2.1 New Objective' (Part C: Corporate Rescue in Spain).

<sup>202</sup> Antonio Fernández, Borja García-Alamán, Adrián Thery and Juan Verdugo, 'Chapter 24. SPAIN' in Christopher Mallon (ed.), *The Restructuring Review* (Law Business Research, 8<sup>th</sup> edn., London 2015) 318. See also Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 *European Company and Financial Law Review* 516, 527.

<sup>203</sup> María-del-Mar Camacho-Miñano, David Pascual-Ezama and Elena Urquía-Grande, 'On the Efficiency of Bankruptcy Law: Empirical Evidence in Spain' (2013) 22 *International Insolvency Review* 171, 173.

<sup>204</sup> without a discharge, all present and future income of the debtor must be used to pay back pre-bankruptcy debts.

<sup>205</sup> Since the entry into force of the Ley Concursal until 2010, out of 17 333 insolvency procedures 835 directors have been found guilty, i.e. around 5 % (Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) 18 <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019).

<sup>206</sup> Antonio Fernández, Borja García-Alamán, Adrián Thery and Juan Verdugo, 'Chapter 24. SPAIN' in Christopher Mallon (ed.), *The Restructuring Review* (Law Business Research, 8<sup>th</sup> edn, London 2015) 318; Antonio Fernandez, 'Another Step' (2010) 94 *European Lawyer* 7; Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 *European Company and Financial Law Review* 516, 528.

strongly embedded in the collective memory of the business community and the declaration of insolvency is still regarded as some sort of ‘death certificate’ of the company,<sup>207</sup> causing unease and distrust among creditors, suppliers and customers.<sup>208</sup>

This ‘stigma’ threat prevents managers to file for *concurso* until there is no other alternative left and, in most cases, when it is already too late (i.e. when there is a critical cashflow shortage and all or most creditors have ceased their business dealings following frequent payment defaults).

### 1.3.2.3 Length and Costs

On average, an in-court reorganisation procedure (*convenio*)<sup>209</sup> takes too much time in Spain.<sup>210</sup> This lack of speed came all the more to the surface in the wake of the economic recession in 2008, when more and larger insolvencies had to be dealt with.<sup>211</sup> Together with the high procedural expenses<sup>212</sup>, which will gradually drain the remaining company’s assets, the slowness of the *concurso* proceedings considerably reduces the chances of corporate rescue.<sup>213</sup>

Even despite the recent establishment of additional specialised courts<sup>214</sup>, the system is still confronted with poor infrastructure and a lack of means in general, as a result of which procedures still take too long.<sup>215</sup>

### 1.3.2.4 Convenio Restrictions

Albeit the primary objective of the LC is to preserve viable businesses through the facilitation of a composition agreement with its creditors, it seems contradictory that the Act simultaneously imposes limits and restrictions on the content of these agreements, whereas under the former regime debtors enjoyed almost complete contractual freedom at any point of the proceedings. The LC introduced several restrictions that are likely to make a *convenio* agreement very difficult to reach.<sup>216</sup> Ironically,

<sup>207</sup> Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, ‘Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?’ (2009 6(4) *International Corporate Rescue* 213, 214.

<sup>208</sup> Antonio Fernandez and Juan Verdugo, ‘The Pain in Spain’ (2009) *Legal Week* 26, 27.

<sup>209</sup> As mentioned above, there is only one formal insolvency procedure (*concurso*), which aims at either reorganisation (*convenio*) or liquidation, depending on the financial health and economic viability of the debtor.

<sup>210</sup> In 2015, the proceedings where an insolvency plan (*convenio*) was passed took on average between 400 and 550 days to complete (cf. Ignacio Tirado, ‘Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.’ (2018) 15 *European Company and Financial Law Review* 516, 527 with reference to Estadística concursal, Registradores de España, available at <http://www.registradores.org/portal-estadistico-registral/estadisticas-mercantiles/estadistica-concursal/>)

<sup>211</sup> Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, ‘Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?’ (2009 6(4) *International Corporate Rescue* 213, 213.

<sup>212</sup> On average, these costs (court fees, notice publication fees, compensation of the court-appointed representatives, etc.) account for a 15% of the company’s total assets (cf. Esteban van Hemmen, *Estadística concursal. Anuario 2007* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2008)). In order to reduce the procedural costs, the Ley Concursal fixed a cap on the level of compensation of the administrators in 2009 (Marco Celentani, Miguel García-Posada and Fernando Gómez, ‘The Spanish Business Bankruptcy Puzzle’ (Law and Finance Seminar Series, Oxford Law School, February 2012) 10 < [http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019.

<sup>213</sup> Antonio Fernandez and Juan Verdugo, ‘The Pain in Spain’ (2009) *Legal Week* 26, 26 (available at [www.legalweek.com](http://www.legalweek.com)).

<sup>214</sup> Carlos Nieto, ‘Judicial consideration of the Schemes of Arrangement’ (2016) *Eurofenix* 42.

<sup>215</sup> Files are not fully digitalized, and the IT system is old fashioned and insufficient to handle great amounts of documentation. Courts are engulfed with papers and documents; there is not enough administrative staff; and the buildings don’t have enough rooms to hold oral hearings, causing massive delays as a consequence (Ignacio Tirado, ‘Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.’ (2018) 15 *European Company and Financial Law Review* 516, 532).

<sup>216</sup> The restrictions are the following: (i) stays of more than five years or a release of more than 50% of the claims; (ii) an overall transfer of the debtor’s assets to the creditors or a global liquidation of those assets in satisfaction of all the claims outside the formal insolvency liquidation process; (iii) alterations of the amount or the classification of the claims set out in the Insolvency Law; (iv) conditional proposals; and (v) neither the debtor, nor the creditors are allowed to amend their proposals in the course of the proceedings (for a discussion on these restrictions, see Jesús Almoguera, ‘Spain: Understanding

plenty of Spain's high-profile business restructurings under the old insolvency rules, would presumably be hampered by these new restrictive rules and would have ended up in liquidation under the LC.<sup>217</sup>

Nor did the LC provide a framework for debt-for-equity swaps.<sup>218</sup> If the creditors believe that the troubled company might prosper again, they might be willing to exchange their debt claim for a stake in the company. In doing so, all or part of the company's debts will be wiped off and the company can resume its business activities.<sup>219</sup> In the author's opinion, the Spanish legislator missed a great opportunity to introduce an interesting tool for companies to restructure their debt.

### 1.3.2.5 Lack of Expertise

Empirical data indicate that the new Commercial Courts were not particularly skilled in distinguishing viable from non-viable debtors.<sup>220</sup> Considering the extremely low number of reorganisations in the past years<sup>221</sup>, there has simply been no or only little opportunity to gain experience 'on the ground'.<sup>222</sup> Besides, these specifically designated courts<sup>223</sup> were not so 'specialised' after all, as they also handled other commercial cases (e.g. transport and intellectual property) and do not receive any training on firm valuation or corporate finance in general.<sup>224</sup>

It goes without saying that the LC's objective of business continuity would be nothing more than an empty box as long as the actors involved in the restructuring process (judges, insolvency practitioners, etc.) remain incompetent to make appropriate business restructuring decisions.<sup>225</sup>

However, it has recently been argued that the technical level of the Spanish judges has increased significantly and a good reputation is being created.<sup>226</sup>

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the New Insolvency Law (II)' 2006 3(3) International Corporate Rescue 158, 158-161).

<sup>217</sup> e.g. Sniace SA was a paper manufacturer that had been in insolvency proceedings since 1992. The composition arrangement that was reached in this case included a stay of eight years and was conditional upon maintaining the commercial activity of certain factories. Secondly, the arrangement provided for an overall transfer of the company's assets to the creditors in satisfaction of all claims, via liquidation outside formal insolvency liquidation proceedings. Other examples are the insolvency cases concerning the companies Ercros SA, Fesa Fertilizantes Españoles SA and Galerías Preciados SA (Jesús Almoguera, 'Spain: Understanding the New Insolvency Law (II)' 2006 3(3) International Corporate Rescue 158, 162).

<sup>218</sup> Company law rules concerning the increase of capital and the treatment of pre-emption rights do not address the specific situation that arises within insolvency.

<sup>219</sup> Miguel Virgós, 'Lessons from the Spanish Experience' (2009) 6(3) International Corporate Rescue 135, 136.

<sup>220</sup> María-del-Mar Camacho-Miñano, David Pascual-Ezama and Elena Urquía-Grande, 'On the Efficiency of Bankruptcy Law: Empirical Evidence in Spain' (2013) 22 International Insolvency Review 171, 186.

<sup>221</sup> See *supra* '1.3.1 Inefficiency Statistics' (Part C: Corporate Rescue in Spain).

<sup>222</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) 12 <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019; See also Luis Díez Picazo, 'Los Juzgados de lo Mercantil' in A. Rojo et al., *La Reforma de la Legislación Concursal* (Marcial Pons, Madrid 2003).

<sup>223</sup> See *supra* '1.2.3 Law 8/2003: Commercial Courts' (Part C: Corporate Rescue in Spain).

<sup>224</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) 12 <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019.

<sup>225</sup> Besides, it would be naïve to expect valuable restructuring insights coming from the court-appointed representatives, as the LC only requires 5 years of practice as a lawyer, auditor or economist to become an administrator without any further specific requirements or qualifications. The remuneration of these practitioners is also not performance-based, so they do not really have an incentive to develop a profound insolvency expertise either (Miguel Virgós, 'Lessons from the Spanish Experience' (2009) 6(3) International Corporate Rescue 135, 136).

<sup>226</sup> Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 European Company and Financial Law Review 516, 532.

## §2. Alternative Insolvency Institutions

### 2.1 Mortgage foreclosures

A foreclosure is a debt enforcement procedure aimed at recovering the money owed to *secured* creditors.<sup>227</sup> It enables a secured creditor<sup>228</sup>, in case of default of the debtor, to seize and sell the encumbered asset(s), *i.e.* the collateral, in order to repay his claim with the proceeds. A variation of this procedure is the so-called ‘friendly foreclosure’, in which the secured lender repossesses the property with the consent of the borrower in exchange for the reduction or the cancellation of the outstanding debt. In Spain, this ‘friendly foreclosure’ mechanism (*dación en pago*) was very popular during the credit crisis owing to the significant advantages it offered compared to formal insolvency proceedings.<sup>229</sup> According to an estimation of the Bank of Spain, it reduces the risk of bankruptcy with 29% to 35%.<sup>230</sup>

First, the Spanish Mortgage Act or *Ley Hipotecaria*<sup>231</sup> is characterized by speed and cost-efficiency.<sup>232</sup> As mentioned earlier, timing is of crucial importance for the rescue of companies in distress. Whereas larger Spanish companies spent on average 2 to 3 years in a *concurso* procedure<sup>233</sup>, a mortgage foreclosure usually takes only 7 to 9 months.<sup>234</sup> In addition, these foreclosure proceedings do not require the (same degree of) involvement of courts, lawyers, administrators and auctioneers as in bankruptcy proceedings, which makes this restructuring alternative not only faster but also much cheaper. Also the fact that a company is not being labeled as ‘insolvent’, gives a company the comfort to restructure without having to worry about its stakeholders’ reactions.

Moreover, it is also beneficial for mortgage creditors, since their claims will not be diluted if they foreclose on the collateral instead of filing for insolvency proceedings, in which the recovery rate for secured creditors will generally be lower due to priority of preferential claims (e.g. legal costs,

<sup>227</sup> Miguel García-Posada and Juan S. Mora-Sanguinetti, ‘Are there alternatives to bankruptcy? A study of small business distress in Spain’ (2014) 5 *SERIEs Journal of the Spanish Economic Association* 287, 288 with reference to Simeon Djankov, Oliver Hart, Caralee McLiesh, Andrei Shleifer, ‘Debt enforcement around the world.’ (2008) 116(6) *Journal of Political Economy* 1105–1149.

<sup>228</sup> It does not protect unsecured creditors, who must still rely on separate insolvency proceedings to enforce their claims.

<sup>229</sup> According to data from the *Consejo General del Poder Judicial* and *Registradores de España*, only 8000 companies filed for *concurso* proceedings in 2012, while there were nearly 26000 mortgage foreclosures in the same year. See also Miguel García-Posada and Juan S. Mora-Sanguinetti, ‘Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution’ (Banco de España, Documentos de Trabajo N.o 1234, 2012) 12.

<sup>230</sup> Miguel García-Posada and Juan S. Mora-Sanguinetti, ‘Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution’ (Banco de España, Documentos de Trabajo N.o 1234, 2012) 39.

<sup>231</sup> *Decreto de 8 de febrero de 1946 por el que se aprueba la nueva redacción oficial de la Ley Hipotecaria*.

<sup>232</sup> The extrajudicial execution of a mortgage (*‘hipoteca’*) is governed by article 222 et seq of the Reglamento para la Ejecución de la Ley Hipotecaria (Decree of February 14, 1947).

<sup>233</sup> Spanish companies spent on average 20-23 months in 2007 in *concurso* proceedings (Esteban van Hemmen, *Estadística concursal. Anuario 2007* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2008); 27-36 months in the period 2008-2010 due to the crisis (Esteban van Hemmen, *Estadística concursal. Anuario 2008* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2009); Esteban van Hemmen, *Estadística concursal. Anuario 2009* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2010); Esteban van Hemmen, *Estadística concursal. Anuario 2010* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2011)). Albeit the crisis only led to a modest increase in the number of insolvency filings, it significantly slowed down the formal process. In 2011, debtors spent on average between 28 and 42 months in *concurso* proceedings (Esteban van Hemmen, *Estadística concursal. Anuario 2010* (Colegio de Registradores de la Propiedad y Mercantiles de España, Madrid, 2011)).

<sup>234</sup> European Mortgage Federation, *Study on the Efficiency of the Mortgage Collateral in the European Union* (EMF Publication, May 2007). The amendments to the Spanish mortgage law (*Ley Hipotecaria*) of 2013 may jeopardize the speed of mortgage foreclosures in the future. E.g. the increase from one to three number of payments that must be missed before the foreclosure process can be started, the suspension of evictions of the debtor for two years the evictions when they are considered to be especially vulnerable, the reformed auction process by amending the Civil Procedure Act, etc. (*Ley 1/2013, de Mayo 14, de medidas para reforzar la protección a los deudores hipotecarios, reestructuración de deuda y alquiler social*).

insolvency receivers' fees, etc.).<sup>235</sup> Furthermore, mortgage foreclosures follow standardised procedure, making its outcome relatively easy to predict and its use eligible for economies of scale.<sup>236</sup>

Unsurprisingly, Spanish companies' capital and asset structure is biased towards mortgage loans and assets that can be pledged as mortgage collateral, such as land, buildings and machinery (*i.e.* tangible fixed assets).<sup>237</sup> Companies even overinvested in these types of assets to be able to grant new security rights in exchange for new finance in the future.<sup>238</sup> Statistical evidence shows that the weight of mortgage debt on total bank debt is substantially higher in Spain than in the rest of Europe.<sup>239</sup>

Such overinvestment, however, leads to productive inefficiencies, which are very costly for industries that mainly work with intangible assets (e.g. R&D) or current assets (e.g. retail trade). Businesses active in these industries are not inclined to resort to the *Ley Hipotecaria* and will rather seek to negotiate an informal workout with their creditors and restructure their debts outside the court.<sup>240</sup>

**Table II: Tangible fixed assets to total assets (%), medians 2006<sup>241</sup>**

SMALL FIRMS	Spain	France	Germany	Italy	AVERAGE
D-Manufacturing	20.6	10.5	14.8	16.9	14.1
E-Electricity, gas and water supply	40.3	20.1	61.6	51.4	44.4
F-Construction	12.0	6.8	9.8	7.0	7.9
G-Wholesale and retail trade	13.3	6.5	7.2	5.9	6.5
H-Hotels and restaurants	40.8	32.3	25.5	46.5	34.8
I-Transport, storage and communication	20.5	10.7	33.7	12.9	19.1
K-Real estate, renting and business activities	22.0	2.5	11.4	4.6	6.2
AVERAGE	24.2	12.8	23.4	20.7	19.0
MEDIUM FIRMS	Spain	France	Germany	Italy	AVERAGE
D-Manufacturing	23.4	13.6	18.1	16.1	15.9
E-Electricity, gas and water supply	55.6	26.9	67.6	24.5	39.7
F-Construction	6.9	4.9	7.0	6.4	6.1
G-Wholesale and retail trade	11.9	6.4	7.4	5.6	6.5
H-Hotels and restaurants	50.7	30.1	25.8	31.3	29.0
I-Transport, storage and communication	28.0	8.0	24.8	10.4	14.4
K-Real estate, renting and business activities	4.5	2.8	11.9	2.9	5.8
AVERAGE	25.9	13.2	23.2	13.9	16.8
LARGE FIRMS	Spain	France	Germany	Italy	AVERAGE
D-Manufacturing	20.9	16.0	18.6	16.0	16.9
E-Electricity, gas and water supply	48.0	44.4	50.3	0.6	31.8
F-Construction	3.4	3.7	8.5	3.7	5.3
G-Wholesale and retail trade	16.4	5.9	6.8	5.3	6.0
H-Hotels and restaurants	16.0	22.0	28.4	13.3	21.2
I-Transport, storage and communication	44.7	7.2	17.7	15.6	13.5
K-Real estate, renting and business activities	7.0	2.9	13.4	3.0	6.4
AVERAGE	22.3	14.6	20.5	8.2	14.4

<sup>235</sup> Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution' (Banco de España, Documentos de Trabajo N.o 1234, 2012) 12.

<sup>236</sup> Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution' (Banco de España, Documentos de Trabajo N.o 1234, 2012) 12.

<sup>237</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019; Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Are there alternatives to bankruptcy? A study of small business distress in Spain' (2014) 5 SERIEs (Journal of the Spanish Economic Association) 287, 294.

<sup>238</sup> e.g. purchasing machinery instead of renting it, although this would be commercially more interesting, in order to be able to pledge the asset in exchange for new finance in the future. See also Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019.

<sup>239</sup> In comparison to firms in other EU countries, the weight of mortgage debt on total bank debt of Spanish companies is substantially higher according to statistics based on data from 1999-2012 from Banque de France, Banco de España and the Office for National Statistics (Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution' (Banco de España, Documentos de Trabajo N.o 1234, 2012) 9). Again, this proves the importance of this type of debt and, thus, mortgage foreclosures as an alternative insolvency institution in Spain.

<sup>240</sup> Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution' (Banco de España, Documentos de Trabajo N.o 1234, 2012) 39.

<sup>241</sup> Marco Celentani, Miguel García-Posada and Fernando Gómez, 'The Spanish Business Bankruptcy Puzzle' (Law and Finance Seminar Series, Oxford Law School, February 2012) <[http://www3.law.ox.ac.uk/denning-archive/news/events\\_files/GOMEZ\\_SPANISH\\_BANKRUPTCY\\_PUZZLE.pdf](http://www3.law.ox.ac.uk/denning-archive/news/events_files/GOMEZ_SPANISH_BANKRUPTCY_PUZZLE.pdf)> accessed 15 February 2019.

## 2.2 Out-of-court Debt Restructuring

### 2.2.1 Inadequate Legislation

In the wake of the credit crunch in 2008, it was common practice among major lenders to seize the debtor's assets in exchange for a release or reduction of their debt claims and sell these assets on more favourable terms than those normally achieved during formal insolvency proceedings (e.g. friendly foreclosures).<sup>242</sup> These informal workouts could be completed in a relatively short time frame, not to mention the increased cost-efficiency and the maintained reputation of the company.<sup>243</sup> However, when constrained bank lending led to the diversification of financial creditors (bondholders, international funds, etc.) after the economic recession,<sup>244</sup> problems of coordination and information asymmetry arose and made it harder to achieve an informal workout.<sup>245</sup>

At that time, the LC did unfortunately not (yet) provide for an adequate out-of-court restructuring framework.<sup>246</sup> One of its most regrettable lacunas was the lack of a 'cramdown' mechanism, as a result of which unanimous consent was always required for restructuring measures to extend to all creditors. Consequently, minority creditors had the power to block a debt restructuring and use the threat of filing for *concurso* in order to be paid off.<sup>247</sup>

Additionally, a standstill period during which creditors would be prevented from enforcing security and filing for insolvency, would have significantly increased a business' rescue chances by allowing it more time to negotiate a restructuring agreement with its creditors.<sup>248</sup>

Besides, business restructurings often require 'fresh money'.<sup>249</sup> Under the LC, the additional security rights banks would get in return for new financing were far from reliable,<sup>250</sup> as they were likely to become subject to 'clawback' actions when the company would enter into bankruptcy.<sup>251</sup> Such lenders

<sup>242</sup> Antonio Fernandez and Juan Verdugo, 'The Pain in Spain' (2009) Legal Week 26, 27.

<sup>243</sup> An informal workout can be described as "a private reorganisation process in which the major financial creditors of the distressed company act in a coordinated manner to either restructure its debt, so that the company can be kept as a going concern, or to liquidate the company's assets in an orderly manner". See also Miguel García-Posada and Juan S. Mora-Sanguinetti, 'Why do Spanish Firms rarely use the Bankruptcy System? The Role of the Mortgage Institution' (Banco de España, Documentos de Trabajo N.º 1234, 2012) 12.

<sup>244</sup> Big companies started issuing bonds to receive extra finance, whereas small and medium-sized companies frequently resorted to international funds that saw an opportunity to obtain high profitability margins in Spanish companies (Alberto Núñez-Lagos Burguera and Álvaro Font Tranco, *Strategic Review – Corporate Restructuring 2016: Spain* (Global Legal Group, 2016) <<http://www.strategicview.co.uk/strategic-view/corporate-restructuring/the-strategic-view-corporate-restructuring-2016/spain>> accessed 16 February 2018).

<sup>245</sup> Stuart Gilson, Kose John and Larry Lang, 'Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default' (1990) 27 Journal of Financial Economics 315–353; Edward Morrison, 'Bargaining around Bankruptcy: Small Business Distress and State Law' (Working Paper No. 320, Columbia University School of Law, 2008); Edward Morrison, 'Bankruptcy's Rarity: An Essay on Small Business Bankruptcy in the United States', *Proceedings from the Second ECFR Symposium on Corporate Insolvency* (October 2007), 172–188.

<sup>246</sup> Rafael Sebastián, 'The Spanish Insolvency Act: A Critical Evaluation' in Katarzyna Gromek Broc and Rebecca Parry (eds), *Corporate Rescue* (Kluwer Law International 2006) 319, 329–330.

<sup>247</sup> Simon Crompton, 'Lawyers messed up Spanish insolvency' (2009) 28(10) I.F.L. Rev. 10–11.

<sup>248</sup> White Page, *The European Restructuring and Insolvency Guide 2002/2003* (Globe White Page Ltd, London, 2002).

<sup>249</sup> In order to overcome its financial difficulties, a viable business in distress often needs extra working capital to continue its economic activities and to keep generating income (Simon Crompton, 'Lawyers messed up Spanish insolvency' (2009) 28(10) I.F.L. Rev. 10–11).

<sup>250</sup> Antonio Fernandez and Juan Verdugo, 'The Pain in Spain' (2009) Legal Week 26, 27.

<sup>251</sup> Art. 71 §1 LC: "*Declarado el concurso, serán rescindibles los actos perjudiciales para la masa activa realizados por el deudor dentro de los dos años anteriores a la fecha de la declaración, aunque no hubiere existido intención fraudulenta.*" (freely translated: "Once the debtor has been declared bankrupt, acts detrimental to the bankruptcy estate carried out by the debtor within two years prior to the date of the declaration can be avoided, even if there was no fraudulent intent."). Avoidance actions constituted a very real and high risk, especially after the landmark case *Banco Spirito Santo*, which made creditors more reluctant to enter into restructuring agreements with debtors (Sentencia del Juzgado de lo Mercantil núm. 1 de Madrid, de 21 mayo 2007, AC\2008\1603). See also Antonio Fernandez and Juan Verdugo, 'The Pain in Spain' (2009) Legal Week 26, 27 (available at [www.legalweek.com](http://www.legalweek.com)).

could even be regarded as ‘accomplices’ (*cómplices*) to the debtor’s insolvency, allegedly having deliberately contributed to the worsening of the company’s financial situation.<sup>252</sup>

Conclusively, out-of-court restructurings were never a great success in Spain due to the aforementioned obstacles *ex ante* (e.g. lack of cramdown, no moratorium etc.) and the potential headaches for creditors *ex post* (e.g. avoidance actions, liability risk, etc.) in the event of bankruptcy afterwards.

## 2.2.2 Forum Shopping for English Schemes

As discussed above, the English scheme of arrangement has in recent times assumed a paramount role in the context of cross-border restructurings. The scheme procedure of s.895 et seq. CA 2006 has proven to be a very powerful tool in high-profile restructuring cases, especially for distressed companies with a complex capital structure involving more tiers of secured debt.<sup>253</sup> For such companies, debt restructuring often seems to be practically impossible given the high – almost unachievable – level of creditor approval under the finance documents.<sup>254</sup> Needless to say, the key feature of a scheme of arrangement, *i.e.* the ability to cram down holdout and dissenting creditors, has played a considerable part in the rise of English schemes in Europe. Together with other advantages such as the flexibility of the procedure, the familiarity with the process, the experience of the English courts and the avoidance of the insolvency stigma, it has incentivized large corporate groups to restructure their debt under English law. As from the financial downturn in 2008, also Spanish companies have increasingly sought financial salvation in the UK.<sup>255</sup>

### i) *La Seda de Barcelona* (2010)<sup>256</sup>

On 26 May 2010, the High Court sanctioned the first scheme ever undertaken by a Spanish company. *La Seda de Barcelona SA*, a manufacturing company of synthetic packaging with its COMI in Spain, applied for a scheme to restructure syndicated debt worth 600 million EUR as part of a larger restructuring.<sup>257</sup>

Restructuring its syndicated debt in Spain was very problematic. *La Seda* either needed unanimous consent from the syndicate lenders or it had to enter into bankruptcy.<sup>258</sup> Albeit the company could not obtain unanimous consent<sup>259</sup>, it was clear from the negotiations that the vast majority of its

<sup>252</sup> Art. 164 §1 *juncto* 166 LC. See also Ignacio Tirado, ‘Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.’ (2018) 15 European Company and Financial Law Review 516, 520.

<sup>253</sup> Michael Rutstein, ‘Roll up! Roll up! Schemes round-up: foreign companies are coming to England to benefit from the scheme of arrangement process.’ (2011) 4(4) Corporate Rescue and Insolvency 125, 127.

<sup>254</sup> Christian Pilkington, Kate Andrews and Kevin Heverin, ‘Re *La Seda de Barcelona SA*: Release of Third Party Claims in the Context of UK Schemes of Arrangement’ (2010) 7(4) International Corporate Rescue 276, 276.

<sup>255</sup> Ángel Alonso Hernández and Álvaro Font Tranco, ‘New Winds From Spain: Celsa’s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start’ (2014) 11(1) International Corporate Rescue 8, 8; Adam Gallagher and Natalia Gómez, ‘Don’t be Misled by the Wording’ (2014) 33(2) American Bankruptcy Institute Journal 48, 48; Lynda Elms and Teresa Camacho, ‘Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?’ (2012) 5(5) Corporate Rescue and Insolvency 180-181; Iñigo Rubio, Cristóbal Cotta and Ignacio Buil Aldana, ‘The New Spanish Scheme and the Recognition of English Schemes in Spain’ (2012) *Financier Worldwide* 1, 1 (available at [www.financierworldwide.com](http://www.financierworldwide.com)); Jaime de San Román, Ángel Pérez López and Eva García Morales, ‘A Spanish warning to dissident creditors’ (*International Financial Law Review*, December 2013) <<http://www.iflr.com/Article/3289105/A-Spanish-warning-to-dissident-creditors.html>> accessed 16 February 2019.

<sup>256</sup> *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

<sup>257</sup> Christian Pilkington, Kate Andrews and Kevin Heverin, ‘Re *La Seda de Barcelona SA*: Release of Third Party Claims in the Context of UK Schemes of Arrangement’ (2010) 7(4) International Corporate Rescue 276, 276.

<sup>258</sup> Ana García and Christopher Bjork, ‘*La Seda* Gets Creditor Approval For U.K. Insolvency Scheme’ (*Daily Bankruptcy Review*, March 2010) <<http://search.proquest.com/docview/195854672?accountid=14693>> accessed 5 February 2019.

<sup>259</sup> To get all members of a syndicate to agree to a debt restructuring is usually quite hard to achieve, because the lenders involved may have differing views on the borrower’s troubled situation that compete with the interests of the syndicate. Difficulties arise when some of the syndicate lenders have no direct relationship with the debtor and, therefore, have little commercial incentive to rescue the debtor’s business for future dealings (Alarna Carlsson-Sweeny, ‘English scheme of

syndicate lenders supported the proposed restructuring.<sup>260</sup> Subsequently, La Seda applied for a scheme and proposed its restructuring plan to a single class meeting of syndicate lenders on 21 May 2010. Over 95% voted in favour of the scheme, as a result of which the opposing minority was bound and La Seda could restructure its syndicate debt.<sup>261</sup>

Furthermore, the issue of third-party releases also arose in the *La Seda* case. Artenius UK Limited, an English subsidiary, was a guarantor of La Seda's obligations under a bank facilities agreement. Artenius had gone into administration and held claims against La Seda and other group companies exceeding 80 million GBP. Proudman J held on the facts that the precondition of a 'give and take' was complied with, since the scheme stipulated that the scheme creditors would release Artenius from all its liabilities as guarantor in exchange for Artenius dropping its intercompany claim against La Seda.<sup>262</sup>

As discussed above in '3.3.3 Recognition Issues' (Part B: English Scheme of Arrangement), given the fact that the recognition of English schemes on the basis of EU law – in particular, the (recast) EIR and the (recast) EJR – is far from certain, their effectiveness abroad also largely depends on local rules of private international law. In the said case evidence was presented that La Seda's restructuring scheme would be recognized considering the choice-of-law provisions (English law) and jurisdiction clauses (English courts) included in the facility agreements.<sup>263</sup> Whilst there is always a risk of public policy override, the *La Seda* scheme was considered to be in the Spanish public interest, because otherwise the company would have entered into bankruptcy proceedings.<sup>264</sup>

## ii) *Metrovacesa* (2011)<sup>265</sup>

Similar to the *La Seda* case, Metrovacesa SA, a large Spanish real estate group with assets in Spain, France and Germany, proposed a scheme compromising a bank facility agreement governed by English law. The approval threshold of only 75% in value of each creditor class permitted Metrovacesa to execute its planned debt restructuring involving debt-for-equity swaps – a restructuring mechanism unavailable in Spain at that time. Interestingly, the bank facilities governed by Spanish law were not included in the scheme and thus still required unanimous consent.

Again the English courts accepted evidence stating that the Spanish courts would recognize the scheme as a matter of private international law. With respect to potential allegations of a breach of

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arrangement: useful for a Spanish restructuring' (PLC UK Restructuring and Insolvency, June 2010) <<http://uk.practicallaw.com/4-502-6385>> accessed 14 February 2019).

<sup>260</sup> Michael Rutstein, 'Roll up! Roll up! Schemes round-up: foreign companies are coming to England to benefit from the scheme of arrangement process.' (2011) 4(4) Corporate Rescue and Insolvency 125, 126.

<sup>261</sup> "All the lenders in the scheme were senior secured lenders under the syndicated facility. The scheme would not have worked if there had been other classes of debt subject to the scheme (unless, of course, they had also agreed by the requisite majorities). This is because a scheme can only cram down a minority within a class. It cannot cram down whole classes that dissent," dixit Richard Tett, legal advisor of La Seda on the English law aspect of the restructuring. (source: Alarna Carlsson-Sweeny, 'English scheme of arrangement: useful for a Spanish restructuring' (PLC UK Restructuring and Insolvency, June 2010) <<http://uk.practicallaw.com/4-502-6385>> accessed 14 February 2019)).

<sup>262</sup> Christian Pilkington, Kate Andrews and Kevin Heverin, 'Re La Seda de Barcelona SA: Release of Third Party Claims in the Context of UK Schemes of Arrangement' (2010) 7(4) International Corporate Rescue 276, 277.

<sup>263</sup> It was argued before the English courts that the scheme would be regarded in Spain as a binding adjustment of creditors' rights under these facility agreements under the law governing these agreements (English law). This is a very important distinctive factor as regards the earlier rejected scheme in the *Equitable Life* case in Germany (see *supra* '3.3.3.2 European Judgments Regulation' (Part B: English Scheme of Arrangement)). In this case, the creditors have contractually agreed for their claims to be dealt with in accordance with English Law by English courts. In the *Equitable Life* case, on the contrary, the relevant insurance policies were governed by German law. See Michael Rutstein, 'Roll up! Roll up! Schemes round-up: foreign companies are coming to England to benefit from the scheme of arrangement process.' (2011) 4(4) Corporate Rescue and Insolvency 125, 126.

<sup>264</sup> Alarna Carlsson-Sweeny, 'English scheme of arrangement: useful for a Spanish restructuring' (PLC UK Restructuring and Insolvency, June 2010) <<http://uk.practicallaw.com/4-502-6385>> accessed 14 February 2019.

<sup>265</sup> *Re Metrovacesa SA* [2011] EWHC 1014 (Ch).



Spanish public policy, it was held that the creditor cramdown did not offend national public policy, because Spain was drafting its own cramdown legislation at that time.<sup>266</sup>

iii) *Cortefiel* (2012)<sup>267</sup>

As Cortefiel SA, a leading Spanish high street clothing retailer, faced severe financial difficulties in 2011, it was clear that it would not be able repay a loan due in 2014. Cortefiel approached its lenders in 2012 and proposed structural amendments to the loan documents to extend its revolving credit facility and reset its financial covenants to a more achievable level in exchange for an margin increase. Pursuant to the loan agreements, each lender that would be affected by these proposed amendments had to consent individually. Albeit Cortefiel had the support of the majority, it failed to achieve all individual consents required. By means of an English scheme (based on its senior facility agreement being subject to English law), the company could implement its ‘amend and extend’ restructuring.<sup>268</sup>

Remarkably, one tranche of senior debt lenders received an additional 15 million EUR prepayment under the scheme, which Cortefiel justified by placing them in a separate class. The English court accepted the class divisions by Cortefiel and ruled that there was sufficient ‘give and take’ within the proposed scheme to constitute a fair compromise arrangement between the debtor and its lenders.<sup>269</sup> One may argue that the leniency with which the court accepted this ‘amend and extend’ proposal may result in companies threatening to use English schemes to force the dissenting minority to give their consent.<sup>270</sup>

iv) *Orizonia* (2013)<sup>271</sup>

Another high-profile case of a Spanish company using an English scheme to restructure its debt relates to the Spanish tour operator Orizonia. In short, the scheme included a write-off of almost 90% of the company’s initial debt and a capital injection of 15 million EUR to finance the acquisition of a competitor Globalia. Around 85% of Orizonia’s secured bank lenders approved the reorganization in a single creditors meeting followed by the English court sanctioning the scheme.

Decisive for Orizonia to restructure in England was the fact that a scheme of arrangement does not require the company to be insolvent or facing imminent insolvency. Secondly, the ability to cram down dissenting and even *secured* creditors was also of significant importance in the restructuring of Orizonia’s debt.

These cases clearly illustrate the unique benefits of the English scheme of arrangement. In light of Spain’s recent efforts to improve its (pre-)insolvency framework, we will analyse whether or not Spanish enterprise groups with complex capital structures and a ‘sufficient connection’ with the UK will continue to fancy the English scheme rather than looking at their local restructuring toolkit

<sup>266</sup> Michael Rutstein, ‘Roll up! Roll up! Schemes round-up: foreign companies are coming to England to benefit from the scheme of arrangement process.’ (2011) 4(4) Corporate Rescue and Insolvency 125, 127.

<sup>267</sup> *Re Cortefiel SA* [2012] EWHC 2998 (Ch).

<sup>268</sup> Christian Pilkington and Hayley Mitchinson, ‘Cortefiel: The Use of Schemes of Arrangement for ‘Amend & Extends’’ (2013) 10(2) International Corporate Rescue 84, 85.

<sup>269</sup> In this decision, the court particularly accorded much weight to the risks encountered by Cortefiel and the loss of value, in case result the scheme was rejected. See Rachel Anthony, Ian Fox and Hayley Çapani, ‘Pushing the envelope: the increased use of schemes of arrangement’ (2014) 1 Corporate Rescue & Insolvency 28, 29.

<sup>270</sup> See also Christian Pilkington and Hayley Mitchinson, ‘Cortefiel: The Use of Schemes of Arrangement for ‘Amend & Extends’’ (2013) 10(2) International Corporate Rescue 84, 84.

<sup>271</sup> *Iberotravel Vacations v Orizonia Destination Management* [2013] EWHC 756 (Ch).

### §3. Genesis of an Effective Restructuring Framework

#### 3.1 RDL 3/2009<sup>272</sup>: The Crisis calls for Solutions

##### 3.1.1 Background

It is clear from all the above that the LC in fact never had the chance to deliver on its promises of business continuity.<sup>273</sup> After its adoption in 2003, the Spanish economy experienced an exponential economic growth, fueled by a fluctuating real estate market due to historically low interest rates and access to cheap finance.<sup>274</sup> Accordingly, the *concurso* procedure introduced by the LC had been barely used in the years following its implementation.<sup>275</sup> When the global credit crunch hit in 2008, Spain's economic landscape changed so radically that the previously adopted framework was no longer in line with the new economic realities and unequipped to deal with the heavily overleveraged companies filing for *concurso*.<sup>276</sup> As it was virtually impossible for debtors to negotiate an in-court composition agreement with their creditors under the ineffective rules of the LC, this inevitably led to piecemeal liquidation of the debtor's assets in 95% of all cases.<sup>277</sup> Due to this destructive nature of the *concurso* procedure, distressed companies attempted to informally negotiate refinancing agreements with their major lenders, often involving a rescheduling of payments term.<sup>278</sup>

As touched upon earlier, creditors in an out-of-court restructuring process faced two major issues.<sup>279</sup> First, transactions entered into by a debtor during the two-year period preceding its insolvency declaration could be avoided (i.e. clawback), if the insolvency court would be of the opinion that the transaction was prejudicial to the debtor's estate.<sup>280</sup> For instance, out-of-court restructuring agreements wherein new security rights are granted in exchange for a haircut or an extension of payments, may be unwound in the event of subsequent insolvency proceedings.<sup>281</sup> Secondly, financiers could be regarded as so-called 'shadow' directors of the distressed company. Hence, a financier should behave solely as a 'lender' and make sure that its controlling rights (often granted in exchange for new finance) do not

<sup>272</sup> *Real Decreto-Ley 3/2009, de 27 de marzo, de medidas urgentes en materia tributaria, nanciera y concursal ante la evolución de la situación económica.*

<sup>273</sup> *Exposición de Motivos, Real Decreto-Ley 3/2009, de 27 de marzo, de medidas urgentes en materia tributaria, nanciera y concursal ante la evolución de la situación económica*, VII: "Aun en este último caso, la ley procura la conservación de las empresas (...) con preferencia a las soluciones que garanticen la continuidad de la empresa." (freely translated: "Even in the latter case, the law procures the conservation of the companies (...) with preference to the solutions that guarantee the continuity of the company."). See also *supra* '1.2.1 New Objective' (Part C: Corporate Rescue in Spain).

<sup>274</sup> Alberto Nuñez-Lagos and Ángel Alonso, 'A time of restructuring opportunities in Spain' (2009) 84 *European Lawyer* 47.

<sup>275</sup> Adam Gallagher, Jesús López Bragado and Jorge Puyol, 'Strengthening Pre-Insolvency Tools' (2014) 33(9) *American Bankruptcy Institute Journal* 36-37 and 60-61.

<sup>276</sup> The Preamble of the law justifies its existence on the significant differences between the current economic environment and that of 2003 when the current Law was enacted, and the fact that the inadequacy of some provisions has only been verified when the financial international crisis has affected directly the companies (*Exposición de Motivos, Real Decreto-Ley 3/2009, de 27 de marzo, de medidas urgentes en materia tributaria, nanciera y concursal ante la evolución de la situación económica*).

<sup>277</sup> See *supra* '1.2.1 Inefficiency Statistics' (Part C: Corporate Rescue in Spain).

<sup>278</sup> Borja García-Alamán and Jose Maria Gil-Robles, 'Spain's insolvency reforms assessed' (*International Financial Law Review*, September 2014) <<http://www.iflr.com/Article/3383530/Spains-insolvency-reforms-assessed.html>> accessed 17 February 2019; Alberto Nuñez-Lagos and Ángel Alonso, 'Spain: Urgent changes to the insolvency framework' (*International Financial Law Review*, October 2009) <[www.iflr.com/Article/2324191/Spain-Urgent-changes-to-the-insolvency-framework.html](http://www.iflr.com/Article/2324191/Spain-Urgent-changes-to-the-insolvency-framework.html)> accessed 17 February 2019; Alberto Nuñez-Lagos and Ángel Alonso, 'A time of restructuring opportunities in Spain' (2009) 84 *European Lawyer* 47.

<sup>279</sup> Adam Gallagher, Jesús López Bragado and Jorge Puyol, 'Strengthening Pre-Insolvency Tools' (2014) 33(9) *American Bankruptcy Institute Journal* 36-37 and 60-61.

<sup>280</sup> See *supra* '2.2.1 Inadequate Legislation' (Part C: Corporate Rescue in Spain).

<sup>281</sup> leaving the creditor in question (most likely a bank or other financial institution) with nothing more than an unsecured claim against an insolvent debtor.

involve the power to dictate the debtor's managerial decisions. If so, the financier might encounter harsh consequences under the LC.<sup>282</sup> These risks associated with refinancing distressed businesses deeply worried the financial community and undeniably hampered the out-of-court restructuring of economically viable companies.<sup>283</sup>

This concern came to the attention of the Spanish legislator in 2009 prompted by a social outcry and lobbying efforts by the Spanish Bank Association,<sup>284</sup> which reacted against certain controversial rulings on avoidance actions.<sup>285</sup> For the first time in Spanish insolvency law history, the legislator was concerned with out-of-court workouts.<sup>286</sup> When Martinsa Fadesa SA, one of Spain's biggest real estate and construction groups, petitioned for bankruptcy on the 14<sup>th</sup> of July 2008,<sup>287</sup> the need for protection of out-of-court workouts even became a priority in Spain, not only to enhance corporate rescue but also to alleviate the increased workload for the Spanish commercial courts.<sup>288</sup>

### 3.2.1 Enhancing Out-of-Court Refinancing

#### 3.2.1.1 Clawback Protection

The main hurdle for lenders to engage in refinancing negotiations with an insolvent borrower, especially after the credit crisis, was the clawback provision under Article 71.1 LC, which states that once the insolvency proceedings are declared open, acts that are detrimental to the aggregate assets performed by the debtor within the two years prior to the date of declaration may be revoked, even though there may not have been a fraudulent intention.<sup>289</sup> Additionally, this provision also included some far-reaching presumptions regarding certain arrangements that were considered to be prejudicial to the debtor's estate (e.g. granting of security rights on debtor's assets in favour of pre-existing

<sup>282</sup> To start with, transactions carried out between the debtor and its (shadow) directors are presumed to be detrimental for the estate and, thus, more likely to be subject to clawback actions. Moreover, claims held by a shadow director will suffer subordination. To cap it all, shadow directors may face the same liability as registered directors for causing insolvency or worsening the financial position of the debtor if the Court finds its management guilty of gross negligence or willful misconduct (Alberto Nuñez-Lagos and Ángel Alonso, 'A time of restructuring opportunities in Spain' (2009) 84 European Lawyer 47).

<sup>283</sup> Antonio Fernandez and Juan Verdugo, 'The Pain in Spain' (2009) Legal Week 26, 28 (available at [www.legalweek.com](http://www.legalweek.com)).

<sup>284</sup> Antonio Fernández, 'Las soluciones preconcursales', in Antonio Fernández, José Antonio Rodríguez and Rafael Sebastián (eds), *La Ley Concursal y su aplicación* (Fundación de Estudios Financieros, paper 33, Madrid) 64-65; Carlos Ara Triadú, 'Are the New Spanish Legally Enhanced Workouts that 'Fancy'? (Son Realmente Tan Atractivos Los Acuerdos De Refinanciación Protegidos Frente Al Concurso?)' (InDret vol. 3, July 2014) 13-14 <<http://ssrn.com/abstract=2501030>> accessed 17 February 2019.

<sup>285</sup> In this regard, the order against *Banco Espirito Santo* from the commercial Judge of Madrid on the 21<sup>st</sup> of May 2007 was a controversial decision. Apart from avoiding the new security interests granted in favour of a pre-existing debt, the bank's claim suffered subordination based on the debatable ground of bad faith (Sentencia del Juzgado de lo Mercantil núm. 1 de Madrid, de 21 mayo 2007, AC/2008/1603) See also Carlos Ara Triadú, 'Are the New Spanish Legally Enhanced Workouts that 'Fancy'? (InDret vol. 3, July 2014) <<http://ssrn.com/abstract=2501030>> accessed 17 February 2019).

<sup>286</sup> In fact the reform, RDL 3/2009 dated 22 March 2009, came too late. On the 6<sup>th</sup> of February 2009, the Court of Appeal of Barcelona had already come up with a new interpretation of the clawback presumptions to neutralise the foresaid precedent (cf. *Banco Espirito Santo*) that deterred banks from engaging in out-of-court workouts. The Court referred to the concept of 'unjustified estate's prejudice', which implies that the sole finding of prejudice, either factual or presumed in accordance with the presumptions of the LC, is not enough to avoid a transaction (Carlos Ara Triadú, 'Are the New Spanish Legally Enhanced Workouts that 'Fancy'? (InDret vol. 3, July 2014) <<http://ssrn.com/abstract=2501030>> accessed 17 February 2019).

<sup>287</sup> Sentencia del Juzgado de lo Mercantil no. 1 de Coruña, de 4 julio 2011, AC/2011/1492.

<sup>288</sup> Although the number of insolvency filings in Spain remained quite low in comparison to other EU countries, even during the crisis, there was indeed a significant increase of formal procedure initiations after the credit crunch that caused severe problems in terms of delay for the Spanish commercial courts.

<sup>289</sup> Fermin Garbayo, 'Spain: corporate insolvency - removing hurdles in the Spanish refinancing markets' (2009) 24(8) Journal of International Banking Law and Regulation N70; Fernández del Pozo, 'Sobre la preconcursalidad y la prevención de la insolvencia. El mecanismo de alerta preconcursal' in A. Rojo (ed.), *La Reforma*, 9-86; Juana Pulgar Ezquerro, 'Rescisión concursal y refinanciaciones bancarias' (2009) Diario La Ley 7097, 1-8; Franciso Garcimartín Alférez, 'Acuerdos de garantía financiera y riesgo concursal: un estudio de los problemas de ley aplicable' (2008) 9 Revista de Derecho Concursal y Paraconcursal 75-86.

debts).<sup>290</sup> Hence, the legal position of creditors willing to assist a debtor in its battle against bankruptcy was far from being sound.<sup>291</sup>

The Royal Decree-Law 3/2009 (hereinafter ‘RDL 3/2009’) finally provided some degree of comfort to those creditors willing to refinance troubled companies. Article 8.3 of RDL 3/2009 adds a new Additional Provision Four to the LC (hereinafter ‘AP4’) that grants protection against clawback to refinancing agreements (*acuerdos de refinanciación*) as defined by article 71bis LC as follows: “*agreements reached by the debtor that significantly increase the credit available or modify the debtor's obligations, either by extending their maturity period or by establishing new obligations to replace pre-existing obligations*”. Though the term ‘refinancing agreements’ seems to suggest that fresh money is being provided, the above definition demonstrates that this does not necessarily have to be the case to enjoy the clawback protection under AP4.<sup>292</sup> Nonetheless, the impact of this new safe harbour may not be overestimated as its scope is quite limited and does not include commonly used restructuring measures such as debt-for-asset transactions.<sup>293</sup>

Also important to note is that security enforcement against the debtor's assets by creditors with whom no refinancing agreement is negotiated is not blocked nor suspended under AP4. As a consequence, other creditors may still seize the debtor's assets, hereby cutting down the security granted in connection with refinancing agreement and jeopardizing the debt restructuring.<sup>294</sup> If only there was a mechanism available to impose a heavily supported restructuring proposal on dissenting and abstaining creditors...

### 3.2.1.2 Pre-insolvency Filing

<sup>290</sup> Currently, Article 71.2 LC: The detriment to assets is presumed, without evidence to the contrary being admissible, when these are acts of disposal without a consideration, except for usual liberalities, and payments or other acts of extinction of obligations whose maturity was later than the declaration opening the insolvency proceedings, except if they had an in rem security, in which case the terms set forth in the following section shall apply. Article 71, 3 LC: In the absence of evidence to the contrary, detriment to assets is presumed in the case of the following acts: 1) Those of conveyance for a consideration performed in favour of any of the persons specially related to the insolvent debtor; 2) Constitution of a security in rem as collateral of pre-existing obligations, or new ones contracted to substitute these; 3) Payments or other acts of termination of obligations that have an in rem security and whose maturity is after the declaration of the insolvency proceedings.

<sup>291</sup> For example, in order to get a haircut on its debts or an extension of their maturity date, the debtor often had to give new security rights to its creditors. Such additional safeguards relate to pre-existing debts and are therefore likely to be subject to clawback actions in subsequent insolvency proceedings. See also Ángel Alonso, ‘New Tools for Restructuring in Spain: A Leap Forward for Quick Restructuring and Some Fine Tuning Changes’ (2012) 9(2) International Corporate Rescue 107, 108; Fermin Garbayo, ‘Spain: corporate insolvency - removing hurdles in the Spanish refinancing markets’ (2009) 24(8) Journal of International Banking Law and Regulation N70.

<sup>292</sup> The provisions relating to clawback protection for refinancing agreements are currently to be found in Article 71bis LC and AP4 now prescribes the rules for a refinancing agreement to be eligible for court homologation (Amended by Article 112 of Act 38/2011, dated 10th October).

<sup>293</sup> This safe harbour of AP4 only applies to refinancing agreements that meet the following requirements: 1) includes a significant increase of creditor an amendment of the terms of the financing either by extending the final maturity thereof or substituting the initial terms and conditions for others; 2) integrated in a viability plan endorsed by an independent expert that allows the continuation of the debtor's operation in the short and medium term; 3) approved by creditors representing at least 3/5 of the debtor's total liabilities; and 4) formalized in a public deed. If all these conditions are fulfilled, the refinancing agreement, including the newly granted security rights thereunder, will not be subject to clawback in subsequent formal proceedings. Furthermore, it is not defined what should be understood as to ‘significant increase’ of credit. This legal uncertainty generated by such undetermined concept will probably be mitigated by the opinion of the independent expert regarding the viability plan. In any case, the open solution adopted by RDL 3/2009 by not specifying an amount of new credit seems wise to the extent that every restructuring has its own circumstances (Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, ‘Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?’ (2009) 6(4) International Corporate Rescue 213, 215). Finally these refinancing agreements are still not entirely ‘bullet proof’, as court receivers still have the right to bring general rescission actions in the course of formal insolvency proceedings under Articles 1111 and 1291 of the Spanish Civil Code. Nonetheless, the burden of proof for this type of civil law claims is much heavier, since evidence of fraudulent intention is required (Código Civil, Real Decreto de 24 de julio de 1889 (last amended by Law No. 20/2011 of July 21, 2007).

<sup>294</sup> Ivan Delgado and Pedro Marques da Gama, ‘Refinancing arrangements: a critical review’ (2009) 89 European Lawyer 52.

We can ask ourselves what good pre-insolvency restructuring tools such as clawback-protected refinancing agreements are, if there is no time to negotiate such agreement since the debtor has a statutory duty to file timely for *concurso*. According to Article 5 LC, a debtor must file for *concurso* within two months after the company's insolvency is known or should have been known.<sup>295</sup> If the company fails to achieve an out-of-court restructuring agreement and enters into formal proceedings, any late filing for insolvency would fall on the rebuttable presumption of guilty insolvency<sup>296</sup> and directors might be held personally liable for damages.<sup>297</sup>

RDL 3/2009 attempted to remedy this pickle by inserting a new paragraph to Article 5 LC. The so-called 'pre-insolvency filing' for a negotiation period ex Article 5.3 LC<sup>298</sup> allows an insolvent debtor, who has commenced refinancing negotiations before the aforementioned 2-month period for insolvency filing has elapsed, to continue negotiating for an additional 3 months and to file for insolvency within one month thereafter in case the negotiations would have amounted to nothing.<sup>299</sup> Apart from the fact that this reduces the risk of liability for directors for failure to file for insolvency, this 'standstill'<sup>300</sup> also halts insolvency filings by other creditors and provides breathing space for the debtor.<sup>301</sup>

## 3.2 Act 38/2011: Out-of-court Restructuring Tools – Now Effective?

### 3.2.1 Improving the RDL 3/2009

The trend to promote out-of-court workouts as an alternative to formal insolvency proceedings continued under Act 38/2011 reforming the Act 22/2003 of July 9, 2003 on bankruptcy law (hereinafter 'Act 38/2011').<sup>302</sup>

Act 38/2011 implemented, *inter alia*, provisions to make the extension of fresh money more attractive to lenders. First, it added a sixth paragraph to Article 71 LC, introducing a new protection against avoidance actions for collective<sup>303</sup> refinancing agreements that significantly increase the available credit or modify their main obligations by, for instance, extending the payment due dates, and respond to a short to mid-term viability plan. After all, reaching a refinancing agreement with a financially ailing debtor was previously considered to be a controversial issue.

Besides, it also introduced a preferential treatment for money granted within the framework of a refinancing agreement, according to which 50% thereof would qualify as an estate claim (*crédito contra la masa*) and rank before all unsecured claims. Before, unsecured new money would rank as

<sup>295</sup> *i.e.* when the debtor fails to meet its current outstanding financial obligations (cash flow insolvency).

<sup>296</sup> Article 165 §1 LC

<sup>297</sup> Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, 'Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?' (2009) 6(4) *International Corporate Rescue* 213, 216.

<sup>298</sup> Currently Article 5bis LC, amended by the Act 38/2011, of 10 October 2011 (*cf.* Ley 38/2011, de 10 de octubre, de reforma de la Ley 22/2003, de 9 de julio, Concursal).

<sup>299</sup> So in fact directors have 6 months to work out an out-of-court debt restructuring starting from the moment the company turns insolvent (2 months in which the company has to file for this so-called 'grace period' + 3 months to negotiate a compromise + 1 month to file for *concurso* proceedings).

<sup>300</sup> Albeit it does not really bring them to a 'standstill', it does stay the hearing of petitions for a mandatory insolvency order. Nor does this period affect security enforcement procedures or set-offs of claims (See also Antonio Fernandez and Juan Verdugo, 'Swift Spanish solutions' (2009) 88 *European Lawyer* 12-13; Ángel Alonso, 'New Tools for Restructuring in Spain: A Leap Forward for Quick Restructuring and Some Fine Tuning Changes' (2012) 9(2) *International Corporate Rescue* 107 108).

<sup>301</sup> This protection was much needed as (minority) creditors often threatened to file for the company's insolvency during its workout negotiations in order to pressure them and obtain repayment of their claims (Alberto Núñez-Lagos Burguera and Ángel Alonso Hernández, 'Amendment to the Spanish Insolvency Law: Will it Pass the Acid Test?' (2009) 6(4) *International Corporate Rescue* 213, 216).

<sup>302</sup> Preámbulo de Ley 38/2011, de 10 de octubre, de reforma de la Ley 22/2003, de 9 de julio, Concursal.

<sup>303</sup> supported by creditors representing at least 60% of the debtor's total liabilities.

ordinary debt in case the debtor would end up in liquidation.<sup>304</sup> Albeit this amendment was definitely a step in the right direction, new money lending unfortunately still has its limits in practice.<sup>305</sup>

More important, the Act 38/2011 introduced a groundbreaking procedure to cram down dissenting creditors, the so-called '*homologación judicial de los acuerdos de refinanciación*' or 'Spanish Scheme', inspired by the English scheme of arrangement. As this 'cramdown', which was completely unknown in Spain's legal tradition until then, is the main focus of this study, the author will elaborate more extensively on this topic in the following chapters.

### 3.2.2 Introduction of the 'Spanish Scheme'

#### 3.2.2.1 Ratio Legis

In 2011, after years of economic recession, there was still only very limited access to credit, whilst many viable Spanish businesses were at risk due to their accumulated debt and needed to be significantly de-leveraged to survive in the market.<sup>306</sup> As mentioned above, due to constrained bank lending after the financial crisis, new types of lenders saw the light in Spain (hedge funds, private investors, etc.). Consequently, the number of financial creditors of Spanish companies grew substantially and to obtain each creditor's consent to a restructuring proposal was practically impossible.<sup>307</sup> Heavily backed refinancing agreements were often blocked by a few dissenting creditors, forcing distressed but viable Spanish companies into *concurso*.<sup>308</sup>

The fact that Spanish companies, such as La Seda and Metrovacesa, rejected their domestic insolvency laws and resorted to the English scheme of arrangement shortly after the Spain's first attempt to boost its (pre-)insolvency framework in 2009 confirmed the need for an effective cramdown mechanism.<sup>309</sup>

#### 3.2.2.2 Procedure

Likewise the English scheme of arrangement, Spain's *homologación judicial* is a court-sanctioned debt restructuring, which involves an informally negotiated arrangement between the debtor and its financial creditors, followed by a procedural phase and the sanctioning or homologation of the arrangement by a court.

In concrete terms, the new AP4<sup>310</sup> prescribed that the debt rescheduling terms of a refinancing agreement, which complies with the requirements set out in Article 71.6 LC (currently Art. 71*bis* LC)<sup>311</sup>, bind dissenting and holdout creditors if: 1) the refinancing agreement is entered into and

<sup>304</sup> e.g. when there are simply no more assets left to pledge or mortgage.

<sup>305</sup> First, new money lending by persons specially related to the debtor, such as shareholders, is excluded from this preferential treatment. Besides, the law talks about "*new money provided in a refinancing agreement*", which entails that new finance transactions that do not qualify as a refinancing agreement according to the conditions set forth by the Spanish Insolvency Act, will neither enjoy this privilege. Lastly, in practice there will rarely be sufficient unsecured assets to repay the post-insolvency creditors, as the most valuable assets are likely to be mortgaged or pledged already in favour of other creditors (Ángel Alonso, 'New Tools for Restructuring in Spain: A Leap Forward for Quick Restructuring and Some Fine Tuning Changes' (2012) 9(2) International Corporate Rescue 107, 108-109).

<sup>306</sup> Adam Gallagher, Jesús López Bragado and Jorge Puyol, 'Strengthening Pre-Insolvency Tools' (2014) 33(9) American Bankruptcy Institute Journal 36, 37.

<sup>307</sup> See *supra* '2.2.1 Inadequate Legislation' (Part C: Corporate Rescue in Spain).

<sup>308</sup> Adam Gallagher, Jesús López Bragado and Jorge Puyol, 'Strengthening Pre-Insolvency Tools' (2014) 33(9) American Bankruptcy Institute Journal 36, 36.

<sup>309</sup> Lynda Elms and Teresa Camacho, 'Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?' (2012) 5(5) Corporate Rescue and Insolvency 180, 181.

<sup>310</sup> Amended by Article 112 of Act 38/2011, dated 10th October.

<sup>311</sup> Due to a lack of consistency in the case law of the Commercial Courts, there used to be controversy about whether the approval of creditors representing at least 3/5 of the debtor's total indebtedness required for protection against clawback under Article 71.6, 1° LC (currently article 71*bis* LC) is also needed for the homologation of a refinancing agreement. Some

approved by creditors representing at least 75% of liabilities held by financial institutions at the time of signing the agreement; and 2) the dissenting creditors do not benefit from security rights *in rem* (*garantía real*), i.e. pledges or mortgages.

Once the debtor had reached a compromise with its creditors, the court clerk would preliminarily evaluate the scheme and, upon request of the debtor, grant a freeze of enforcement proceedings for a maximum period of one month.<sup>312</sup> Then the court would investigate whether the refinancing agreement complies with the formal and substantive requirements set forth by the LC.<sup>313</sup>

If the court would ultimately sanction the scheme, dissenting and abstaining *unsecured* financial institutions would be equally bound by the terms of the scheme. If requested, the court could even impose a stay of enforcement during the term of the compromise (without exceeding 3 years).<sup>314</sup> Important to note is that compromised creditors, who voted against the scheme, have 15 days<sup>315</sup> to challenge the sanctioning of the scheme on the grounds that the required threshold of creditor approval was not reached or that the scheme entails a ‘disproportionate sacrifice’ (*sacrificio desproporcionado*) for the objecting creditors.<sup>316</sup>

### 3.2.2.3 Obstacles and Limitations

The introduction of the Spanish Scheme was undoubtedly the most groundbreaking development of the 2011 reforms. However, the limitations of this court-sanctioned refinancing agreement reflected the Spanish legislator's reluctance to adopt a far-reaching cramdown mechanism like its English inspiration. For the reasons set out below, the Spanish Scheme would often fall short on its effects in practice.

First, a Spanish Scheme could not bind the dissenting creditors to all the terms of the arrangement, but solely to the provisions relating to payment extensions.<sup>317</sup> A scheme could for instance not impose, haircuts or debt-for-equity swaps in a restructuring. These pre-insolvency tools would be particularly useful considering businesses being heavily overleveraged in Spain.<sup>318</sup> Hence, the limited scope of the

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scholars argue that this condition does not apply to the sanctioning of a Spanish Scheme, since there is no reason to require the votes of creditors, who are not going to be affected by the scheme. Given that this viewpoint has been repeatedly confirmed by the Spanish Courts (*cf.* Auto del Juzgado de lo Mercantil no. 6 de Barcelona, de 5 de junio de 2012, CENDOJ 08019470062012200001; Auto del Juzgado de lo Mercantil no. 3 de Gijón, 99/2012, de 10 de julio de 2012, BOE 10.7.2012, 36056; Auto del Juzgado de lo Mercantil no. 1 de Santa Cruz, de 18 de enero de 2013, CENDOJ 38038470012013200001; Auto del Juzgado de lo Mercantil no. 2 de Barcelona, de 10 de abril de 2013, CENDOJ 08019470022013200001 (‘Sivis SA’)), it seems reasonable to interpret this reference to the requirements of Article 71.6 LC made in AP4 as solely aiming at the substantive conditions and not this creditor approval threshold, which seems to conflict with the schemes legislation’s own threshold of 75% of the financial liabilities. However, contradictory decisions have been issued, requiring both majorities to be met (*cf.* Auto del Juzgado de Primera Instancia no.4 y Mercantil de Jaen de 7 de febrero de 2012, F.D. no.3; Auto del Juzgado de lo Mercantil no. 2 de Sevilla de 21 de mayo de 2012, AC 2012/1498). This issue has been settled in favour of the first interpretation by the Commercial Court of Barcelona in the well-known Celsa-case (*cf.* Auto del Juzgado de lo Mercantil no. 5 de Barcelona, 408/2013-6, de 28 de junio de 2013, BOE 2.7.2013, 33765, §5.1) and afterwards by Act 14/2013 on Support for Entrepreneurs and Internationalisation of 27 September 2013. See Fernando Azofra Vegas, *La homologación judicial de acuerdos de refinanciación* (2nd edn, Editorial Reus 2018) 76. See also *infra* ‘3.3 Celsa scheme (2013): Favourable Clarification by the Courts’ and ‘3.4 Act 14/2013: Homologation Threshold lowered to 55%’ (Part C: Corporate Rescue in Spain).

<sup>312</sup> i.e. former AP4 §2 LC, amended by art. 13 of Royal Decree-law 4/2014, of March 7 (*Real Decreto-ley 4/2014, de 7 de marzo*). Currently, AP4 §5 LC allows for an automatic moratorium until the homologation decision.

<sup>313</sup> AP4, §2 LC (currently AP4, §5-6 LC).

<sup>314</sup> former AP4, §3 LC.

<sup>315</sup> From its publication in the Public Insolvency Register (*Registro Público Concursal*) and in the Official State Gazette (*Boletín Oficial del Estado*).

<sup>316</sup> AP4, §4 LC (currently AP4, §7 LC).

<sup>317</sup> E.g. debt reductions, margins improve, interest capitalization, subordination and debt-for-asset agreements are commonly agreed in this type of negotiations (Ángel Alonso, ‘New Tools for Restructuring in Spain: A Leap Forward for Quick Restructuring and Some Fine Tuning Changes’ (2012) 9(2) *International Corporate Rescue* 107, 108).

<sup>318</sup> See also María Romero and Itziar Sola, ‘Recent measures for refinancing and restructuring Spain’s corporate debt: Opportunities and impact on the banking sector’ (2014) 3(3) *Spanish Economic and Financial Outlook* 15; Alberto Núñez-

Spanish Scheme considerably curtailed a debtor in its flexibility to restructure its (tiered) indebtedness. Therefore, the Spanish Scheme was often thought to be of little use for large companies with complex financial structures.<sup>319</sup>

Secondly, for a compromise to be eligible for homologation, it would have to qualify as a ‘*refinancing agreement*’ meeting the requirements prescribed in 71.6 LC. One of the most burdensome among these requirements<sup>320</sup> was the obtainment of the formal opinion of an independent expert on the viability of the debtor’s business in the short and medium term.<sup>321</sup> This time-consuming condition was considered detrimental to the scheme, because speed is usually of crucial importance in order to preserve business continuity.<sup>322</sup>

Lastly, following the strict reading of the law, the Spanish Scheme would only bind financial institutions (*entidades financieras*). First, it was unclear what/who qualifies as a ‘*financial institution*’. Does this term cover bondholders? And what about hedge funds?<sup>323</sup> Apart from these interpretative issues, the effectiveness of the Spanish Scheme would significantly increase if it did not make this distinction and could bind all types of creditors instead. The burden of the restructuring could then be shared among a broader range of participants.<sup>324</sup>

Probably most remarkable, was the fact that secured creditors could not be crammed down under a Spanish Scheme, especially because after the economic crisis lenders would no longer extend new credit without being granted security interests in return.<sup>325</sup> In practice, however, some creditors often were ‘undersecured’ and could be bound for the unsecured part of their claims. Notwithstanding, unsecured debt would in any case only account for a relatively small amount of the debtor’s total indebtedness.<sup>326</sup> Needless to say, for this cramdown mechanism to be effective the possibility to bind secured creditors as well was essential.

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Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) *International Corporate Rescue* 216; Adam Gallagher, Jesús López Bragado and Jorge Puyol, ‘Strengthening Pre-Insolvency Tools’ (2014) 33(9) *American Bankruptcy Institute Journal* 36, 37.

<sup>319</sup> Lynda Elms and Teresa Camacho, ‘Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?’ (2012) 5(5) *Corporate Rescue and Insolvency* 180, 182.

<sup>320</sup> Some practitioners also criticize the legal expertise of the independent experts, who are mostly economists or auditors. Generally speaking, they lack a proper understanding of the Spanish insolvency laws. Hence, the experts qualified to assess the short-term and medium-term economic viability of a business plan, are often completely unaware of and, thus, unfamiliar with certain security rights legislation, for instance. Therefore, one might argue that their analysis is not as accurate as it should concerning some crucial legal issues (Carlos Ara Triadú, ‘Are the New Spanish Legally Enhanced Workouts that ‘Fancy’? (Son Realmente Tan Atractivos Los Acuerdos De Refinanciación Protegidos Frente Al Concurso?)’ (InDret vol. 3, July 2014) 20 <<http://ssrn.com/abstract=2501030>> accessed 17 February 2019).

<sup>321</sup> Benardino Muñiz, ‘New restructuring regime in Spain’ (2012) *Eurofenix* 25, 26. See also *infra* ‘3.5.4.1 Expert Opinion’ (Part C: Corporate Rescue in Spain).

<sup>322</sup> Benardino Muñiz, ‘New restructuring regime in Spain’ (2012) *Eurofenix* 25, 26; Alberto Núñez-Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) *International Corporate Rescue* 216, 219.

<sup>323</sup> Iñigo Rubio and Ignacio Buil Aldana, ‘Recent developments in Spanish Schemes of Arrangement’ (*Financier Worldwide*, October 2013) <[http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8\\_mDMcp1FI](http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8_mDMcp1FI)> accessed 14 February 2019.

<sup>324</sup> Lynda Elms and Teresa Camacho, ‘Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?’ (2012) 5(5) *Corporate Rescue and Insolvency* 180, 181.

<sup>325</sup> Ángel Alonso Hernández and Álvaro Font Tranco, ‘New Winds From Spain: Celsa’s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start’ (2014) 11(1) *International Corporate Rescue* 8, 9; Lynda Elms and Teresa Camacho, ‘Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?’ (2012) 5(5) *Corporate Rescue and Insolvency* 180, 181; Alberto Núñez-Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) *International Corporate Rescue* 216, 216.

<sup>326</sup> Lynda Elms and Teresa Camacho, ‘Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?’ (2012) 5(5) *Corporate Rescue and Insolvency* 180, 181; Ángel Alonso, ‘New Tools for Restructuring in Spain: A Leap Forward for Quick Restructuring and Some Fine Tuning Changes’ (2012) 9(2) *International Corporate Rescue* 107, 108.



### 3.2.3 Interim Conclusion

In light of the disadvantages discussed above, the usefulness of the Spanish Scheme was definitely questionable. Considering that secured creditors could not be crammed down and almost all financial debt was secured as a result of the financial crisis, it was not surprising that only few Spanish Schemes had been sanctioned in the years after its introduction.<sup>327</sup> Unlike its English role model, the Spanish Scheme was mainly used for the restructuring of less sophisticated debtors and not for high-profile and complex restructurings, such as those of La Seda and Metrovacesa.<sup>328</sup>

Conclusively, although the introduction of this court-sanctioned refinancing agreement was definitely to be celebrated, further amendments were necessary to fully equip and enable this new restructuring tool to be able to compete with its English equivalent.<sup>329</sup>

## 3.3 Celsa Scheme (2013)<sup>330</sup>: Favourable Clarification by the Courts

### 3.3.1 Facts

Eventually in June 2013, the first large-scale debt restructuring under a Spanish Scheme saw the light. After a year of negotiating with over 40 financial institutions, the Celsa Group, one of Spain's largest steel manufacturing companies, with a net debt of approximately 2.8 billion EUR managed to agree on a restructuring plan with its financial creditors. Broadly speaking, it concerned an extension of 5 years of the different debt categories with a repayment schedule. Albeit this proposal got the approval of creditors representing over 90% of Celsa's financial liabilities, it could only pass the viability test if the other 10% creditors would be equally bound by the compromise.<sup>331</sup> Consequently, Celsa applied for the homologation of the agreement in order to cram down these creditors, in spite of the fact that their claims were secured under a lending syndicate. On 28 June 2013, the Commercial Court of Barcelona sanctioned the agreement, thereby homologating the largest cramdown Spain had seen since the Spanish Scheme was introduced in 2011.

### 3.3.2 Interpretative Issues

Importantly, this judgment clarified certain interpretative issues of the AP4's application in a remarkable manner, which will be discussed hereinafter.

#### *Syndicate Lenders*

In the present case, the dissenting financial creditors of a lending syndicate could not enforce security

<sup>327</sup> Ángel Alonso Hernández and Álvaro Font Tranco, 'New Winds From Spain: Celsa's Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start' (2014) 11(1) *International Corporate Rescue* 8, 9. Examples of

<sup>328</sup> Lynda Elms and Teresa Camacho, 'Schemes of arrangement: to what extent has the new Spanish Scheme been inspired by its English equivalent?' (2012) 5(5) *Corporate Rescue and Insolvency* 180, 181; X, 'Europe: Celsa Cramdown' (*International Financial Law Review*, December 2014) <<http://www.iflr.com/Article/3410378/Europe-Celsa-cramdown.html>> accessed 17 February 2019.

<sup>329</sup> *cf.* Cortefiel and Orizonia. See also *supra* '2.2.2 Forum Shopping for English Schemes' (Part C: Corporate Rescue in Spain).

<sup>330</sup> Auto del Juzgado de lo Mercantil no. 5 de Barcelona, 408/2013-6, de 28 de junio de 2013, BOE 2.7.2013, 33765.

<sup>331</sup> Jaime de San Román, Ángel Pérez López and Eva García Morales, 'A Spanish warning to dissident creditors' (*International Financial Law Review*, December 2013) <<http://www.iflr.com/Article/3289105/A-Spanish-warning-to-dissident-creditors.html>> accessed 17 February 2019.

because they lacked the necessary majority prescribed in the syndicate documents.<sup>332</sup> The Court reasoned that because these creditors did not have the power to enforce their security individually, they *de facto* had no security at all and their position was similar to that of an unsecured creditor. Therefore, the Court ruled that these creditors were “*formally, but not materially*” secured and could therefore be treated as unsecured creditors and crammed down under AP4.<sup>333</sup> As syndicated financing is the main source of funding for large Spanish companies, this new interpretation opened the door for an out-of-court cramdown of secured creditors and thus significantly increased the attractiveness of the Spanish Scheme.

### *Payment Extensions*

Remarkably, the reasoning above was not contested by the dissenting syndicate lenders.<sup>334</sup> However, the homologation would eventually be challenged on the grounds that the 5-year repayment schedule in the scheme exceeded the maximum 3-year extension period laid down in the (former) AP4.<sup>335</sup> The Commercial Court of Barcelona confirmed that the 3-year limit of AP4 only applies to the freeze of enforcement actions by the dissenting financial creditors, and not to the payment deferrals agreed in the refinancing agreement.<sup>336</sup> The rationale behind it was that if the objective of the Spanish Scheme is to restore debtor’s viability, the extension of payment maturity dates should not be restricted to three years.<sup>337</sup>

### *‘Disproportionate Sacrifice’*

The court also provided some guidance as to what should be understood by the term ‘disproportionate sacrifice’. For instance, the higher the percentage of financial institutions backing the agreement, the less credible the challenge on the grounds of disproportionality will be. Additionally, if the chances on repayment of the challenging creditor(s) increase under the scheme compared to the scenario in which the debtor would enter into *concurso*, the challenge will not be successful either.<sup>338</sup>

<sup>332</sup> Ángel Alonso Hernández and Álvaro Font Tranco, ‘New Winds From Spain: Celsa’s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start’ (2014) 11(1) *International Corporate Rescue* 8, 9;

<sup>333</sup> Although this ruling of the Commercial Court no. 5 of Barcelona was welcomed from a restructuring perspective, both scholars and judges were more reluctant and stated that it moved the goalposts far beyond the terms of the law at that time (Ángel Alonso Hernández and Álvaro Font Tranco, ‘New Winds From Spain: Celsa’s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start’ (2014) 11(1) *International Corporate Rescue* 8, 9.)

<sup>334</sup> It must be pointed out that the dissident creditors accepted their qualification as unsecured creditors and, accordingly, admitted that their claim against Celsa was eligible to be compromised by the scheme (Jaime de San Román, Ángel Pérez López and Eva García Morales, ‘A Spanish warning to dissident creditors’ (*International Financial Law Review*, December 2013) <<http://www.iflr.com/Article/3289105/A-Spanish-warning-to-dissident-creditors.html>> accessed 17 February 2019).

<sup>335</sup> This was decided in the Ruling of the Commercial Court of Gijón dated July 10, 2012 (Auto del Juzgado de lo Mercantil no. 3 de Gijón, 99/2012, de 10 de julio de 2012, BOE 10.7.2012, 36056). See also Iñigo Rubio and Ignacio Buil Aldana, ‘Recent developments in Spanish Schemes of Arrangement’ (*Financier Worldwide*, October 2013) <[http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8\\_mDmcp1FI](http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8_mDmcp1FI)> accessed 17 February 2019;

<sup>336</sup> This line of reasoning was already adopted in the by the Commercial Court of Seville on May 21, 2012 (Auto del Juzgado de lo Mercantil no. 2 de Sevilla, de 21 de mayo de 2012, AC 2012/1498) and by the Courts of Jaen on February 7, 2012 (Auto del Juzgado de Primera Instancia no.4 y Mercantil de Jaen de 7 de febrero de 2012, F.D. no.3.).

<sup>337</sup> Auto del Juzgado de lo Mercantil no. 5 de Barcelona, 408/2013-6, de 28 de junio de 2013, BOE 2.7.2013, 33765, §12. See also Iñigo Rubio and Ignacio Buil Aldana, ‘Recent developments in Spanish Schemes of Arrangement’ (*Financier Worldwide*, October 2013) <[http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8\\_mDmcp1FI](http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/#.V8_mDmcp1FI)> accessed 17 February 2019; Jaime de San Román, Ángel Pérez López and Eva García Morales, ‘A Spanish warning to dissident creditors’ (*International Financial Law Review*, December 2013) <<http://www.iflr.com/Article/3289105/A-Spanish-warning-to-dissident-creditors.html>> accessed 17 February 2019.

<sup>338</sup> Auto del Juzgado de lo Mercantil no. 5 de Barcelona, 408/2013-6, de 28 de junio de 2013, BOE 2.7.2013, 33765, §9. This view was later also adopted by the European Commission (EC Recommendation of 12 March 2014 on a new approach to business failure and insolvency [2014], C(2014) 1500 final, §22).

### Majorities

As touched upon earlier, it has not always been clear from the case law of the commercial courts<sup>339</sup> whether the sanctioning of a refinancing agreement requires both the 3/5 approval threshold of Article 71.6 LC<sup>340</sup> as well as the 75% majority laid down in AP4 to be met. In the *Celsa* case, the Court of Barcelona ruled that although the strict reading of the LC requires both thresholds to be met, the financial entities are the only creditors affected by the cramdown and, therefore, only the latter approval threshold of AP4 applies for the homologation of a Spanish Scheme.<sup>341</sup> Nonetheless, if the debtor additionally seeks clawback protection, the 3/5 majority of 71.6 LC will have to be complied with anyway.

### 3.3.3 Interim Conclusion

Judges<sup>342</sup> and practitioners<sup>343</sup> expressed their doubts with regard to this interpretation that went undeniably far beyond the literal wording of the law, especially in relation to the cramdown of secured syndicate lenders. In the author's opinion this ruling was to be welcomed, as such rescue-oriented approach significantly advanced the effectiveness of the Spanish Scheme and definitely made it more attractive to debtors. Moreover, the threat of a – now effective – cramdown was also expected to change the bargaining dynamics in informal workouts.<sup>344</sup>

However, it should be noted that certain key issues were still unsettled after *Celsa*. For instance, the term 'financial entity' remained unclear.

<sup>339</sup> See *supra* '3.2.2.2 Procedure' (Part C: Corporate Rescue in Spain).

<sup>340</sup> Currently Article 71*bis* LC.

<sup>341</sup> The Court also relied upon the legal principle '*lex specialis derogat legi generali*' and stated that AP4, which specifically relates to the *homologación judicial*, prevails over the more general provision of Article 71.6 LC.

<sup>342</sup> Opposed to the wide interpretation of the Commercial Courts of Barcelona and, by extension, all of Catalonia, Commercial Courts in other parts of Spain have followed a more literal interpretation of the Spanish Insolvency Act and have explicitly stated that the homologation of a refinancing agreement shall not affect secured dissident creditors whatsoever (*cf.* Auto del Juzgado de lo Mercantil de Madrid no. 6 de 17 de diciembre de 2012, CENDOJ 28079470062012200017, F.D. no.4; Auto del Juzgado de lo Mercantil no. 3 de Gijón, 99/2012, de 10 de julio de 2012, BOE 10.7.2012, 36056 ('Tableros y Puentes SA')). The *Celsa* scheme was later, to a great extent, confirmed by the commercial judges of Catalonia in the course of one of their seminars, which are regularly held as to unify their jurisprudential approach as regards unclear insolvency issues ('Seminario de Jueces Mercantiles de Catalunya de 5 de julio de 2013', as referred to in Fernando Azofra Vegas, *La homologación judicial de acuerdos de refinanciación* (2nd edn, Editorial Reus 2018) 76). Albeit the criteria set forth in these seminars do not have the authoritative power of case law, they may nonetheless serve as guidance for judges when interpreting the provisions relating to the Spanish Scheme. See Iñigo Rubio and Ignacio Buil Aldana, 'Recent developments in Spanish Schemes of Arrangement' (Financier Worldwide, October 2013) <<http://www.financierworldwide.com/recent-developments-in-spanish-schemes-of-arrangement/>> accessed 17 February 2019.

<sup>343</sup> See for example: Ángel Alonso Hernández and Álvaro Font Tranco, 'New Winds From Spain: *Celsa*'s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start' (2014) 11(1) International Corporate Rescue 8, 9.

<sup>344</sup> *Ibid.*

### 3.4 Act 14/2013: Homologation Threshold lowered to 55%

In 2013, shortly after the decision in the *Celsa* case, Spain enacted the so-called ‘Entrepreneur’s Law’ or Act 14/2013 on Support for Entrepreneurs and Internationalisation (hereinafter ‘Act 14/2013’).<sup>345</sup> Most legislative changes introduced by this law only affect small and medium-sized companies. Taking into account that this study primarily focuses on large enterprise groups and forum shopping, this chapter will not discuss these reforms.<sup>346</sup>

On the other hand, Act 14/2013 also introduced other notable amendments such as, inter alia, the lowering of the approval threshold for homologation under AP4 and the introduction of a new Article 71*bis* LC, replacing the former Article 71.6 LC, hereby amending the regime for the appointment of an independent expert who has to issue a report on the debtor’s viability.<sup>347</sup>

As touched upon earlier, there had been some debate about the interaction between the 3/5 threshold to avoid clawback actions under Article 71.6 LC, and the 75% majority required for the cramdown of dissenting creditors in accordance with AP4. In this respect, the Act 14/2013 confirmed the *Celsa* case law<sup>348</sup> and clarified that only threshold to be met is the one of AP4. On top of that, it strongly reduced this approval threshold for court homologation to a sheer 55%. Given the fact that the financial climate in Spain is characterized by a fragmentation of debt and a diversity of creditors’ interests,<sup>349</sup> the former 75% majority was hard to achieve and had to be reduced to make the Spanish Scheme a workable restructuring tool.<sup>350</sup>

Albeit this 55% majority seems very attractive at first sight, the Spanish Scheme could still only bind *unsecured* creditors qualifying as ‘financial entities’ and merely impose payment deferrals of maximum three years.<sup>351</sup>

<sup>345</sup> Ley 14/2013, de 27 septiembre 2013, de apoyo a los emprendedores y su internacionalización, BOE 28.9.2013.

<sup>346</sup> First, Act 14/2013 creates for the first time in Spanish legal history a discharge mechanism for individuals by amending former Article 178.2 LC. Unfortunately, this so-called ‘fresh start’, i.e. the cancellation of unpaid debt of the individual, is subject to severe conditions and restrictions, which makes it highly doubtful that this reform will succeed in tackling the problem of directors’ reluctance to file in a timely manner for insolvency. Secondly, this reform also introduced a new out-of-court settlement of payments (*acuerdo extrajudicial de pagos*) under a new Title X (Articles 231-242 LC) in the Spanish Insolvency Act available to natural persons and companies with fewer than 50 creditors, without liabilities exceeding 5 million EUR. See also Miguel García-Posada and Juan S. Mora-Sanguinetti, ‘Are there alternatives to bankruptcy? A study of small business distress in Spain’ (2014) 5 *SERIEs Journal of the Spanish Economic Association* 287, 324; Ángel Alonso Hernández and Álvaro Font Tranco, ‘New Winds From Spain: Celsa’s Scheme, New Out-of-Court Restructuring Alternatives for Entrepreneurs and a (not so) Fresh Start’ (2014) 11(1) *International Corporate Rescue* 8, 13.

<sup>347</sup> Before this amendment, the independent expert was appointed by the competent Commercial Registrar at its own criteria. The Act 14/2013 introduces a new article 71*bis* LC which sets out a more detailed set of provisions relating the appointment of the independent expert.

<sup>348</sup> Auto del Juzgado de lo Mercantil no. 5 de Barcelona, 408/2013-6, de 28 de junio de 2013, BOE 2.7.2013, 33765 (‘Celsa Scheme’). See *supra* ‘3.3 Celsa Scheme (2013): Favourable Clarification by the Courts’ (Part C: Corporate Rescue in Spain).

<sup>349</sup> See *supra* ‘2.2.1 Inadequate Legislation’ (Part C: Corporate Rescue in Spain).

<sup>350</sup> Prámbulo de Ley 14/2013, de 27 septiembre 2013, de apoyo a los emprendedores y su internacionalización, BOE 28.9.2013.

<sup>351</sup> It is important to note that the Act 14/2013 did not follow the reasoning of the court in the *Celsa* case in this respect. See also *supra* ‘3.3 Celsa Scheme (2013): Favourable Clarification by the Courts’ (Part C: Corporate Rescue in Spain).

### 3.5 RDL 4/2014: The Rise of the Spanish Scheme

#### 3.5.1 Widening the Scope

##### *Ratione Personae*

In order to overcome the confusion about the term ‘financial entities’ – one of the main hurdles of the Spanish Scheme at that time –, the Royal Decree-Law 4/2014 on urgent matters in relation to refinancing agreements and debt restructuring (hereinafter ‘RDL 4/2014’)<sup>352</sup> changed the wording of the *ratione personae* of the Spanish Scheme to ‘creditors holding financial claims at the time of the scheme’s approval’. Notwithstanding the fact that the LC does not define ‘financial claims’,<sup>353</sup> the discussion about the possibility to impose a scheme on institutional investors or hedge funds had been resolved.<sup>354</sup> Creditors holding financial claims, regardless of their (regulatory) nature and whether or not they are subject to supervision,<sup>355</sup> could from then on be crammed down under the amended AP4.<sup>356</sup>

More importantly, after the (too?) inventive case law developed by the Catalan Courts (*cf.* Celsa) to bypass the dissent of certain secured (syndicate) lenders<sup>357</sup>, this reform enshrined the possibility to cram down creditors holding *in rem* security (*garantía real*) explicitly in the law.<sup>358</sup> Given the fact secured debt usually represents a great deal of a company’s total indebtedness, especially these creditors should be able to be crammed down under AP4.

It goes without saying that these amendments were a giant step forward in the development of the Spanish Scheme. However, it is important to keep in mind that the AP4 still excluded claims resulting from commercial operations and those held by public creditors.

##### *Ratione Materiae*

Whereas the former AP4 only allowed payment deferrals to be extended to dissenting creditors, the

<sup>352</sup> Royal Decree-Law 4/2014 of 7 March 2014, on urgent matters in relation to refinancing agreements and debt restructuring, BOE no. 58, 8.3.2014.

<sup>353</sup> According to Alberto Núñez-Lagos Burguera, former president of INSOL Europe and head of restructuring and insolvency of one of Spain’s biggest law firms, ‘financial claims’ should be interpreted as those claims (no matter who the holder is) deriving from a contractual relation which original purpose was to finance the debtor or any third party (e.g., the debtor acting as guarantor) in any way (and thus with no commercial or trade origin) regardless of how such financial claims are documented, provided they are not held by a public body or institution (Alberto Núñez-Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) International Corporate Rescue 216, 217).

<sup>354</sup> This is an important development because a large part of corporate debt originated by banks is now held by hedge funds, which could initially not be crammed down to the extent that they were not considered ‘financial entities’. See also *supra* ‘2.2.1 Inadequate Legislation’ (Part C: Corporate Rescue in Spain).

<sup>355</sup> AP4, §1 LC.

<sup>356</sup> Iñigo Rubio and Ignacio Buil Aldana, ‘The new Spanish Scheme: cramdown, secured creditors and valuation’ (Financier Worldwide, May 2014) <<https://www.financierworldwide.com/the-new-spanish-scheme-cram-down-secured-creditors-and-valuation#.XGlpS2V8VFI>> accessed 17 February 2019.

<sup>357</sup> See *supra* ‘3.3 Celsa Scheme (2013) Favourable Clarification by the Courts’ (Part C: Corporate Rescue in Spain).

<sup>358</sup> AP4, §2 LC The use of the term “*garantía real*” (*in rem* security) in AP4, §2 LC includes any type of security which enables the creditor to sell or repossess the asset in order to apply the value obtained to the discharge of the claim. Mortgages and pledges on hard assets, cash, receivables qualify as security *in rem*. Also collateralised bonds issued by financial institutions, early termination provision in purchase and sale agreements in the event of default of the purchase price, provided they are duly perfected through registration, would definitely qualify as security. It is debatable whether duly registered financial lease agreements under which either a building or a hard asset is financed qualifies as security for the purposes of AP4 (Alberto Núñez-Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) International Corporate Rescue 216, 217) However, the scope of this study does not allow me to go deeper into the interpretation of “*garantía real*”.

RDL 4/2014 substantially expands the range of restructuring options that can be imposed on dissenting or holdout creditors under a Spanish Scheme. The amended AP4 provides more alternatives like, for instance, write-offs, debt-for-equity swaps, debt-for-asset swaps and participative profit loans.

These new restructuring measures are better equipped to rescue heavily overleveraged Spanish businesses.

### 3.5.2 New Majorities

As a consequence of the various types of restructuring measures added to the AP4 LC and their difference in hardship for a company's (dissenting) creditors, the RDL 4/2014 removed the general 55% threshold and introduced a number of new majorities.

First, it should be noted that the approval thresholds are calculated on the basis of the value of the debt claims, though disregarding financial claims held by special parties affiliated to the debtor will be disregarded for the calculation of the required majorities.<sup>359</sup>

Furthermore, creditors in a lending syndicate should be regarded as a whole, and all of them are deemed to support the refinancing agreement if creditors holding at least 75% (or a lower percentage if so established in the syndicate documents) of the total syndicated debt value vote in favour of the scheme.<sup>360</sup> This means that the dissentient minority will be dragged along by the majority and be equally bound by the effects of the restructuring agreement.<sup>361</sup> Considering the *Celsa* scheme analysed above, it is clear that this reform will play an important role in many Spanish restructurings in the future.<sup>362</sup>

#### 3.5.2.1 Clawback Protection

Initially, the AP4 §1 provided for a general approval threshold of 75% of the total financial debt, which was later reduced to 55% by the Act 14/2013<sup>363</sup>, in order to get a restructuring plan homologated by the Spanish courts and its terms (i.e. payment deferrals of maximum three years) extended to dissenting and holdout creditors included in the scheme.

The required majority to enjoy protection against clawback in the event of subsequent *concurso* proceedings, on the other hand, is traditionally determined by Article 71*bis* §1 b) 1° LC at 3/5 of the company's total debt.

<sup>359</sup> AP4, §1 2 LC. The terms of the scheme, once sanctioned by the court, will nonetheless bind these creditors. The term 'special parties related to the debtor' are defined in Article 93, §2 LC (e.g. shareholders, directors or family).

<sup>360</sup> AP4, §1, 4 LC.

<sup>361</sup> The strict reading of the law causes some confusion about whether the 'general' cramdown majorities (60% and 75% for unsecured, respectively 65% and 80% for secured creditors) discussed below must still be adhered to for dissident creditors of a syndicate to be affected by the agreement, or whether the aforesaid 75% majority applicable to syndicated facilities suffices. The Commercial Courts of Madrid have ruled in favour of the former, more restrictive, interpretation and decided that the remaining 25% of the syndicate would only be deemed to have voted in favour of the refinancing agreement for the purpose of the calculations of the standard majority rules in AP4. Conclusively, holdouts and dissenters within a syndicate are only bound by the terms of the refinancing, if the standard rules and majorities for cramdowns lead to that conclusion. Albeit this is the view of the majority of scholars and practitioners in Spain, it might nonetheless differ from the one followed by the judges in the Catalan Courts (*cf.* *Celsa* case). See also Ignacio Buil Aldana and José Luis Lucena, 'Spain: Judges drive distressed investing' (2015) 34(19) *International Financial Law Review* 68 (International Briefings) <<http://www.iflr.com/Article/3447538/Spain-Judges-drive-distressed-investing.html>> accessed 9 February 2019. For further information on this discussion, see Alberto Núñez-Lagos Burguera, 'Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions' (2014) 11(4) *International Corporate Rescue* 216).

<sup>362</sup> See *supra* '3.3 *Celsa* Scheme (2013): Favourable Clarification by the Courts' (Part C: Corporate Rescue in Spain).

<sup>363</sup> See *supra* '3.4 Act 14/2013: Homologation Threshold lowered to 55%' (Part C: Corporate Rescue in Spain).

As discussed above, there has been some controversy about how these majorities interact with each other and, more specifically, whether the 3/5 majority of Article 71*bis* LC still needed to be complied with in the framework of *homologacion judicial* proceedings.<sup>364</sup>

Since the enactment of RDL 4/2014, there can no longer be any dispute about the majority required for a Spanish Scheme to be protected against clawback actions. At present, AP4 §1 clearly defines the (i) threshold for a homologated agreement with clawback protection, i.e. 51% of the total financial debt; and (ii) the majorities required for its terms to be extended to dissenting creditors (AP4 §1 *in fine*), which will be discussed hereinafter in sections 3.5.2.2-3.

In conclusion, refinancing agreements supported by creditors representing at least 3/5 of the company's total debt continue to benefit from clawback protection under Article 71*bis* LC. Additionally, refinancing agreements that meet the requirements of Article 71*bis*, §1 LC except for the 3/5 majority, will also be clawback-protected, if approved by creditors representing at least 51% of the debtor's financial debt and subsequently homologated by the court.<sup>365</sup>

### 3.5.2.2 Cramdown: Unsecured Claims<sup>366</sup>

The following effects of a refinancing agreement will be extended to dissenting or holdout creditors without any security rights as a result of the court homologation:

- a) If approved by creditors holding at least 60% of the total financial debt:
  - Payment deferrals up to 5 years;
  - Conversions of debt into profit participating loans (PPLs) up to 5 years.
- b) If approved by creditors representing at least 75% of the total financial debt:
  - Payment deferrals of 5-10 years;
  - Debt write-offs;
  - Debt-for-equity swaps;
  - Conversions of debt into PPLs for a term of 5-10 years or into convertible bonds, subordinate loans, capital interest loans or any other financial instrument with a different rank, maturity or nature than the original debt;<sup>367</sup>
  - Debt-for-asset swaps.

### 3.5.2.3 Cramdown: Secured Claims

The effects listed above can also be imposed on *secured* creditors, provided that other, slightly higher, majorities are met. First, to impose the effects mentioned in paragraph a) on these creditors, the compromise must be backed by creditors representing at least 65% of all secured financial claims.<sup>368</sup> The extension of the effects mentioned in paragraph b) is conditioned upon the approval by 80% of all secured financial creditors.

<sup>364</sup> See *supra* '3.2.2.2 Procedure' and '3.3.2 Interpretative Issues' *in fine* (Part C: Corporate Rescue in Spain).

<sup>365</sup> Following the strict reading of the law, this new clawback protection seems to be almost absolute, given that no one but the insolvency receiver can challenge these court-sanctioned agreements and only on the basis that the required majorities were not reached (*cf.* Art. 72 §2 LC). See also Iñigo Rubio and Ignacio Buil Aldana, 'The new Spanish Scheme: cramdown, secured creditors and valuation' (Financier Worldwide, May 2014) <<https://www.financierworldwide.com/the-new-spanish-scheme-cram-down-secured-creditors-and-valuation#.XGlpS2V8VFI>> accessed 17 February 2019; Beatriz Rúa, 'Approach to Spanish insolvency framework after 2014's amendments' (2015) 28(4) *Insolvency Intelligence* 56, 56; Iñigo de Luisa and Ignacio Buil Aldana, 'New Refinancing Schemes in Spain' (2014) 8(1) *Insolvency and Restructuring International* 27, 28.

<sup>366</sup> AP4, §3 LC.

<sup>367</sup> Needless to say, this provision provides the necessary flexibility in the context of corporate restructuring as it substantially widens the ability to reschedule debts and impose the agreed restructuring on dissenting creditors.

<sup>368</sup> AP4, §4 LC.

It should be noted that only the part of the claim that is covered by the collateral is taken into account for the calculation of these percentages. If the amount of the claim exceeds the value of the collateralized asset, the (under)secured creditor will be treated as an unsecured creditor for the unsecured part of his claim.<sup>369</sup>

Consequently, the valuation of *in rem* security is crucial to the question whether or not a certain threshold has been met and thus whether the effects of a scheme will be extended to dissenters. Therefore, the RDL 4/2014 introduced a number of criteria for the valuation of *in rem* security in AP4 LC. The value of a security interest will be determined at 90% of the fair value of the collateralized asset<sup>370</sup>, minus the claims of creditors with a privilege on the asset and the claims that rank higher (in case multiple security rights are vested in a single asset to the benefit of more than one creditor).<sup>371</sup>

Secured creditors whose claims exceed the value of their *in rem* security may also vote on the effects extended to unsecured creditors (for the unsecured amount of their claim) and thus have in fact the power to impose restructuring measures on unsecured creditors – which would constitute a different “class” under an English scheme of arrangement<sup>372</sup>. In fact, the Spanish Scheme procedure foresees only two separate, but widely construed creditor classes (secured vs. unsecured creditors). This appears to leave some room for a so-called ‘cross-class cramdown’ in practice. After all, different types of unsecured creditors (e.g. subordinated creditors, ordinary creditors, preferential creditors, etc.), who would each constitute a separate ‘class’ under an English scheme, since they might not be affected in the same way by the proposed restructuring measures and rank differently in a subsequent liquidation scenario, are not able to vote separately on the approval of a Spanish scheme. As a result, creditors could be bound to a restructuring plan following the approval thereof by other creditors with dissimilar interests in the company’s restructuring.

However, the threat of a ‘cross-class cramdown’ should not be overestimated. AP4 §7 allows dissenting creditors a 15-day term to challenge a homologated restructuring agreement, inter alia, on the basis that it entails a disproportionate sacrifice for them. In determining whether or not a sacrifice is ‘disproportionate’, the Spanish doctrine tends to look at the effects of the compromise on the creditors crammed down thereunder compared to the effects on the creditors supporting it.<sup>373</sup> Needless to say, a cross-class cramdown as described above is likely to cause a significant imbalance between the ‘sacrifice’ required from dissenting as against the one suffered by approving creditors, which would eventually, if challenged, lead to the revocation of the homologation.

### 3.5.3 Equity Cramdown?

As highlighted earlier, debt-for-equity swaps are becoming increasingly popular, as they are an interesting restructuring tool for overleveraged businesses. In recent times, refinancing agreements

<sup>369</sup> AP4, §3 and §4 LC.

<sup>370</sup> According to AP4, §2, 2 LC, fair value shall be construed as: a) in the case of securities listed on an official secondary market or another regulated market, or in monetary market instruments, the average weighted price which has been negotiated in one or several regulated markets in the last quarter prior to the date of commencement of the negotiations to reach the refinancing agreement, pursuant to the certification issued by the company governing the official secondary market or the regulated market concerned; b) in the case of real estate, that resulting from the report issued by a recognised appraisal company registered with the special Register at the Bank of Spain; c) in the case of assets other than those stated in the preceding letters, that resulting from the report issued by an independent expert pursuant to the valuation principles and provisions generally recognised for such assets.

<sup>371</sup> Special rules apply to collateralized assets in relation to which multiple security rights have been granted to more than one creditor (e.g. multiple mortgages vested in a building) and claims that have been secured by multiple collateralized assets (*cf.* AP4, §2, 6-7 LC).

<sup>372</sup> See *supra* ‘2.2.2.3 “... or any class of them”’ (Part B: English Scheme of Arrangement).

<sup>373</sup> Alberto Núñez-Lagos Burguera, ‘Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions’ (2014) 11(4) International Corporate Rescue 216, 220; José María Mesa Molina and Alberto Álvarez Marín, ‘Court Approval of Refinancing Agreements in Spain’ (2016) 63 Eurofenix 35, 37.



more and more involve lenders taking over ownership of the company.<sup>374</sup> In this regard, Spain's largest banks have recently implemented a general policy, the so-called '*Fenix Project*', which aims at rescuing overleveraged but viable business through debt capitalisation.<sup>375</sup>

In light of the above, the RDL 4/2014 has introduced certain measures to facilitate debt-for-equity swaps in Spain.<sup>376</sup> Holders of financial liabilities that have been (partially) capitalized in the course of a refinancing under AP4, are now excluded from the concept of "*specially related persons*".<sup>377</sup> Consequently, their claims will not be subordinated on these grounds in case the debtor enters into bankruptcy afterwards.<sup>378</sup> Secondly, with a view to prevent blocking minorities, the RDL 4/2014 allows dissenters to opt for a write-off of the amount equivalent to the par value of the shares, instead of having their debts capitalized.<sup>379</sup>

Last but not least, the reform reduces the approval required at the general shareholders' meeting for a debt capitalization – which is in fact a sort of capital increase – to a simple majority, when it is proposed under a Spanish Scheme.<sup>380</sup>

Notwithstanding, debt-for-equity swaps thus still require the shareholders' approval in order for new shares to be issued. This inability to cram down equity often hampered debt restructurings in the past.<sup>381</sup> The 'nominal' rights of shareholders are not aligned with their 'actual' economic interests, which are likely to be virtually non-existent in a refinancing scenario.<sup>382</sup>

To bring the interests of the different stakeholders in a restructuring process more in line with the economic reality, RDL 4/2014 further introduced a presumption *juris tantum* of willful misconduct or gross negligence on the part of the shareholders, when they frustrate the restructuring process by unreasonably rejecting a proposed debt capitalization.<sup>383</sup> If the debtor subsequently enters into *concurso*, the aforesaid presumption will apply and, if not rebutted, the dissentient shareholders will

<sup>374</sup> Ignacio Buil Aldana, 'Spanish Restructurings in 2015: Will the 2014 Reform Incentivise Debt-for-Equity Swaps in the context of Refinancing Transactions?' in *Market Outlook 2015* (Financier Worldwide, 2015) 9.

<sup>375</sup> Antonio Fernández, Borja García-Alamán, Adrián Thery and Juan Verdugo, 'Chapter 24. SPAIN' in Christopher Mallon (ed.), *The Restructuring Review* (Law Business Research, 8<sup>th</sup> edn. London 2015) 319.

<sup>376</sup> Also outside the ambit of the Spanish Insolvency Act: The takeover bid Royal Decree 2007 has been amended under the auspices of RDL 4/2014 with respect to debt capitalisations where the target company suffers severe financial difficulties. These transactions are exonerated from the obligation to launch a public takeover bid, provided that their objective is to restore the financial viability of the business in the long term (Ignacio Buil Aldana, 'Spanish Restructurings in 2015: Will the 2014 Reform Incentivise Debt-for-Equity Swaps in the context of Refinancing Transactions?' in *Market Outlook 2015* (Financier Worldwide, 2015) 8).

<sup>377</sup> Article 93, §2, 2<sup>o</sup> LC.

<sup>378</sup> In addition, these creditors will no longer be regarded as *de facto* directors or face liability as '*accomplices*' to the worsening of the debtor's financial position in the subsequent event of insolvency on the sole basis of them entering into a refinancing agreement with the debtor. After all, the extension of new finance is often conditioned upon the granting of certain control rights in the company's management to the refinancer. See also Ignacio Buil Aldana, 'Spanish Restructurings in 2015: Will the 2014 Reform Incentivise Debt-for-Equity Swaps in the context of Refinancing Transactions?' in *Market Outlook 2015* (Financier Worldwide, 2015) 8.

<sup>379</sup> AP4, §3, b) 3<sup>o</sup>, i) LC: The creditors who have not agreed to the conversion of their claim into equity may opt for a haircut equivalent to the par value of the shares that they would otherwise have obtained.

<sup>380</sup> A debt-for-equity swap under Spanish law is technically structured as a capital increase through a set-off (debt against shares of the debtor) or contribution in kind. However, in relation to debt-for-equity swaps implemented following the sanctioning of a Spanish Scheme, AP4, §3, b) 3<sup>o</sup>, ii) LC reduces the approval required at the general shareholders' meeting of the company to an ordinary majority (50%+1), by including an explicit reference to Article 198 and 201.1 of the Spanish Companies Act (Real Decreto Legislativo 1/2010, de 2 de julio, por el que se aprueba el texto refundido de la Ley de Sociedades de Capital, BOE 3.7.2010).

<sup>381</sup> Adam Gallagher, Jesús López Bragado and Jorge Puyol, 'Strengthening Pre-Insolvency Tools' (2014) 33(9) *American Bankruptcy Institute Journal* 60-61.

<sup>382</sup> If the company enters formal insolvency proceedings, the claims of shareholders against the insolvency estate will rank last, after creditors, and are therefore very unlikely to get repaid. See Iñigo Rubio and Ignacio Buil Aldana, 'The new Spanish Scheme: cramdown, secured creditors and valuation' (Financier Worldwide, May 2014) < <https://www.financierworldwide.com/the-new-spanish-scheme-cram-down-secured-creditors-and-valuation#.XGlpS2V8VFI> > accessed 17 February 2019; Ignacio Buil Aldana, 'Spanish Restructurings in 2015: Will the 2014 Reform Incentivise Debt-for-Equity Swaps in the context of Refinancing Transactions?' in *Market Outlook 2015* (Financier Worldwide, 2015) 9.

<sup>383</sup> Amendment by Article 11 of Royal Decree-Law 4/2014 (currently Article 165 §2 LC).

be held liable for any shortfall the creditors might suffer as a result of the rejection of the proposed debt capitalization.<sup>384</sup>

### 3.5.4 Other Important Amendments

#### 3.5.4.1 *Expert Opinion*

The RDL 4/2014 abolished the time-consuming requirement to obtain an expert opinion on the restructuring proposal.<sup>385</sup> Instead, the auditor of the debtor only has to certify that the required majorities have been met (Article 71*bis*, §1, 2 LC).

Although this reform seems to substantially speed up the process and save costs, it is still recommended to obtain the formal opinion of an independent expert in order to be able to prove the fairness and reasonability of the restructuring proposal to avoid clawback actions in the event of formal insolvency proceedings, to convince a judge that the scheme is worthy of homologation and that not disproportionate sacrifice has been imposed on dissenting creditors or potentially to force shareholders to consent to a debt-for-equity swap.<sup>386</sup>

#### 3.5.4.2 *Enforcement Stay*

RDL 4/2014 also amended the pre-*concurso* filing of Article 5*bis* LC.<sup>387</sup> Once the debtor has filed for this moratorium, enforcement actions against assets that are necessary for the debtor's business are no longer possible and ongoing foreclosures of such goods will be suspended until the decision of the court on the homologation of the proposed restructuring. Furthermore, no single enforcement of financial claims may be initiated (and those initiated will be halted) provided that creditors representing no less than 51% of the debtor's total financial debt expressly supported the commencement of negotiations under Article 5*bis* LC and committed to abstain from pursuing enforcement actions during these negotiation.<sup>388</sup>

Important to note is that this freeze of foreclosures does not apply to public creditors (e.g tax claims and social security claims).<sup>389</sup>

<sup>384</sup> With regard to what is meant by an 'unreasonable rejection', the independent expert report plays a decisive role. If such a report states that there is just cause for a debt capitalization, opposing (and thus blocking) shareholders are likely face personal liability if the debtor eventually ends up in *concurso* proceedings. As a consequence, the aforesaid report could in practice be used as an instrument to force shareholders to consent to debt-for-equity swaps (cf. Article 165 §2 LC). See also Ignacio Buil Aldana, 'Spanish Restructurings in 2015: Will the 2014 Reform Incentivise Debt-for-Equity Swaps in the context of Refinancing Transactions?' in *Market Outlook 2015* (Financier Worldwide, 2015) 9.

<sup>385</sup> See *supra* '3.2.2.3 Obstacles and Limitations' (Part C: Corporate Rescue in Spain).

<sup>386</sup> See also Benardino Muñoz, 'New restructuring regime in Spain' (2012) *Eurofenix* 25, 26; Alberto Núñez-Lagos Burguera, 'Recently Enacted Spanish Out-of-Court Debt Restructuring Laws Join the Current European Trends for Efficient Restructuring and Lead Innovation for Restructuring Solutions' (2014) 11(4) *International Corporate Rescue* 216, 219; Agustín Bou, 'Too Many Ineffective Amendments to the Spanish Insolvency Law' (2015) 12(3) *International Corporate Rescue* 162, 163.

<sup>387</sup> This communication is a formal requirement and there is only a superficial control that the legal requirements are met. See *supra* '3.1.2.2 Pre-insolvency Filing' (Part C: Corporate Rescue in Spain).

<sup>388</sup> Article 5*bis*, §4, 4 LC.

<sup>389</sup> Pursuant to Article 5*bis*, §4, 6 LC, administrative charge proceedings initiated by public creditors will not be suspended by a pre-*concurso* filing. This preferential treatment of public creditors has been criticized because of its destructive consequences for small and medium-sized companies, whose vast majority of debts are held by public creditors. See Agustín Bou, 'Too Many Ineffective Amendments to the Spanish Insolvency Law' (2015) 12(2) *International Corporate Rescue* 162, 162; Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 *European Company and Financial Law Review* 516, 523.

### 3.5.5 Status Quo

RDL 4/2014 has brought about some substantial changes to Spain's (pre-)insolvency legislation such as, *inter alia*, reduced majorities for out-of-court clawback protection, improvement of the cramdown mechanism, diversification of restructuring options, etc.<sup>390</sup> In short, this new framework is far better equipped to rescue viable businesses than the previous so-called "amend and extend", or - as it was also referred to due to its ineffectiveness - the "*extend and pretend*" regime.<sup>391</sup>

However, the reform did not persistently push through and ignored some of the key issues of corporate restructurings, such as the inability to cram down equity, even though the newly introduced shareholders liability in case of a debt capitalization being unreasonably rejected might significantly reduce their power to block debt restructurings.<sup>392</sup>

Equally unfavorable is the fact that public creditors continue to be immune to the imposed freeze of enforcement.

Another potential issue – which is often forgotten but has nonetheless proven to be crucial to the restructuring of enterprise groups – is that claims are often guaranteed by other companies within the same group. The possibility to release or amend such guarantees without the guarantor having to file for a reorganization procedure itself (costs, stigma, etc.) is often crucial to the success of the restructuring of a group.<sup>393</sup> Overseas, third party releases have proven to be an adequate and mutually acceptable solution to seemingly impossible restructuring scenarios (e.g. *La Seda* scheme).<sup>394</sup>

Unfortunately, the Spanish legislator did not (yet) cease the opportunity to adopt rules regarding third party releases.<sup>395</sup> As a result, creditors that involuntarily undergo payment extensions and/or haircuts at the level of the debtor can still exercise their rights vis-à-vis joint-obligors and guarantors. To overcome this lacuna, group schemes have been filed for, which not only include the debtor (principal obligor), but also all its subsidiaries and affiliated companies that have acted as guarantor or are jointly liable for some of its debts.<sup>396</sup>

Be that as it may, the present AP4 LC now includes many tools that initially incentivized Spanish companies to 'shop' for English schemes of arrangement in the past (e.g. cramdown of secured claims

<sup>390</sup> In chronological order: Act 38/2011, of 10 October, amending Law 22/2003, of 9 July, on Insolvency; Act 14/2013 of 27 September on support for entrepreneurs and their internationalisation; Act 26/2013 of 27 December on savings banks and banking foundations; Royal Decree-Law 4/2014 of 7 March 2014, on urgent matters in relation to refinancing agreements and debt restructuring; Act 17/2014 of 30 September adopting urgent measures on the refinancing and restructuring of corporate debt; Act 9/2015, of 25 May, on urgent measures in bankruptcy matters. Only the most significant amendments to the Spanish Scheme have been elaborated on above.

<sup>391</sup> Under the former AP4 LC, only payment extensions could be imposed on dissenting and holdout creditors under a Spanish Scheme. As explained earlier, the sole rescheduling of payment terms is not able to cope with the financial difficulties of heavily overleveraged Spanish companies in the long term. As a consequence, plenty of viable businesses still ended in liquidation (Iñigo de Luisa and Ignacio Buil Aldana, 'New Refinancing Schemes in Spain' (2014) 8(1) *Insolvency and Restructuring International* 27, 28).

<sup>392</sup> Iñigo Rubio and Ignacio Buil Aldana, 'The new Spanish Scheme: cramdown, secured creditors and valuation' (Financier Worldwide, May 2014) <<https://www.financierworldwide.com/the-new-spanish-scheme-cram-down-secured-creditors-and-valuation#.XGlpS2V8VFI>> accessed 17 February 2019; Ignacio Buil Aldana and José Luis Lucena, 'Spain: Can equity be crammed down?' (International Financial Law Review, December 2014) <<http://www.iflr.com/Article/3408618/Spain-Can-equity-be-crammed-down.html>> accessed 15 February 2019.

<sup>393</sup> See Michael Veder and Adrian Théry, 'The release of third party guarantees in pre-insolvency restructuring plans' in Bas Kortmann, Dennis Faber, Ben Schuijling, Niels Vermunt (eds), *Trust and good faith across borders, Liber amicorum* (Deventer - Wolters Kluwer 2017) 259-274.

<sup>394</sup> *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

<sup>395</sup> Section 9 of AP4 explicitly states: "*The creditors holding financial liabilities who have not signed the homologation agreement, or who have expressed their disapproval thereof but who are affected by the homologation, shall preserve their rights against those bound jointly and severally with the debtor and before its backers and guarantors, who may not invoke neither the approval of the refinancing resolution nor the effects of the homologation to their detriment.*"

<sup>396</sup> See Francisco José Leon Sanz, 'La reforma de los acuerdos de refinanciación preconcursales' (Working Paper IE Law School, nr. AJ8-216, 2014) 12 <<https://catedraperezllorca.ie.edu/sites/default/files/AJ8-216.pdf>> accessed 17 February 2019.

and debt-for-equity swaps).<sup>397</sup> Time will tell whether the amended Spanish Scheme achieves the same outcomes as its English inspiration and succeeds in efficiently restructuring large and financially complex Spanish companies in their home country.

**Table III: Majorities and effects of the Spanish Scheme**

Voting creditors	Majority	Compromised creditors	Effects
Holders of financial claims	51% of total financial debt	All creditors	Clawback protection
Holders of financial claims	60%/75% of total financial debt	Holders of unsecured (or undersecured) financial liabilities	Stays / debt-equity swaps / conversion into PPL / haircuts / etc.
Holders of <u>secured</u> financial claims	64/80% of the secured financial debt by value of security	Holders of secured financial liabilities	Stays / debt-equity swaps / conversion into PPL / haircuts / etc.

<sup>397</sup> Iñigo de Luisa and Ignacio Buil Aldana, 'Spain: Reworking the Spanish Scheme' (International Financial Law Review, March 2014) <<http://www.iflr.com/Article/3322780/Spain-Reworking-the-Spanish-scheme.html>> accessed 17 February 2019; Beatriz Rúa, 'Approach to Spanish insolvency framework after 2014's amendments' (2015) 28(4) Insolvency Intelligence 56, 56.

### 3.6 The Spanish Scheme: 4 years' practice

Statistical data concerning the success of the Spanish Scheme - although relatively scarce to date - indicate that from 2015 to early 2017, there have been around 200 successfully homologated schemes.<sup>398</sup> Although this number may appear quite low at first, one must keep in mind that most cases concern medium-sized to large companies, even including some very large multinational groups.<sup>399</sup> Therefore, it can be argued that the added value of the assets and liabilities involved in Spanish Schemes gives the out-of-court procedure a much higher relevance compared to formal proceedings.<sup>400</sup>

During these years, very large Spanish companies have resorted to this pre-insolvency procedure such as, inter alia, the leading construction company FCC, the Bodybell Group, telecommunications company Abengoa and the Madrid-based engineering company Grupo Isolux Corsan, as a result of which years later, many unresolved issues have been settled by way of precedent-setting and the rules are now much better defined:

– *FCC*<sup>401</sup>

In a much-awaited ruling of the Commercial Court of Barcelona concerning the restructuring of the construction group FCC, the concept of 'disproportionate sacrifice' was further clarified following a challenge brought by dissenting creditors crammed down by a Spanish Scheme.<sup>402</sup>

The Court rejected the challenge and decided that (i) a sacrifice is disproportionate when similar creditors are treated unequally or when creditors of a preferential rank suffer greater losses than those of a lower rank ; (ii) the proportionality of sacrifice must be based on the specific measures adopted in the refinancing agreement without taking external interests or incentives into account ; (iii) observations concerning the debtor's (in)solvency at the time of filing for the Spanish Scheme are irrelevant for the determination of a potentially disproportionate sacrifice.

– *Bodybell*<sup>403</sup>

The restructuring terms that are "crammable" on holdouts and dissenting creditors listed in AP4 §3-4 LC have often been narrowly interpreted by the Spanish courts.<sup>404</sup> Measures typically proposed in debt restructurings, such as the change of debtor or cancellation of security, would generally be considered to go beyond the scope of the aforementioned provisions. However, in the *Bodybell* case, the Commercial Court of Madrid clarified that *in rem* security can be cancelled if it can be shown that the security interests on the collateralized asset have no actual value (e.g. when the asset has also been pledged to other creditors with a higher rank) and that the cancellation thereof thus does not entail a sacrifice.

<sup>398</sup> Source: the Spanish Official Gazette (*Boletín Oficial del Estado*, available at [www.boe.es](http://www.boe.es)), and the Professional Body of Economists of Spain, available at [www.economistas.es](http://www.economistas.es).

<sup>399</sup> e.g. the restructuring of the Abengoa Group included 46 group companies.

<sup>400</sup> Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 European Company and Financial Law Review 516, 534.

<sup>401</sup> Auto del Juzgado de lo Mercantil no 10 de Barcelona, 1099/14-A, de 12 de enero de 2015, BOE 18.1.2015, 3395.

<sup>402</sup> Sentencia Civil Juzgados de lo Mercantil – Barcelona, Sección 10, Rec 286/2016 de 29 de Noviembre de 2016.

<sup>403</sup> Auto del Juzgado de lo Mercantil no 11 de Madrid, 760/2015, de 20 de octubre de 2015, BOE 30.10.2015, 45335.

<sup>404</sup> Carlos Nieto, 'Judicial consideration of the Schemes of Arrangement' (2016) *Eurofenix* 42, 43; Ignacio Tirado, 'Out of court Debt Restructuring in Spain. A Modernised Framework' (2017) *European Company and Financial Law Review* 1, 24 <[www.law.ox.ac.uk/sites/files/oxlaw/tirado\\_modernised\\_framework.pdf](http://www.law.ox.ac.uk/sites/files/oxlaw/tirado_modernised_framework.pdf)> accessed 17 February 2019.

– *Abengoa*<sup>405</sup>

The restructuring of Abengoa's group in 2015 was probably the largest restructuring in Spain (with an initial debt of 20 billion EUR) due to its global impact on the entire group, which counts more than 600 group companies.

On 25 September 2017, the Seville court ruled with regard to the master restructuring agreement that contingent creditors are in principle no "*holders of financial claims*" within the meaning of AP4 as their claims have not yet materialized.<sup>406</sup> This view was already presented to the court of Barcelona in the *FCC* case.<sup>407</sup>

Another issue on which the court had to decide on concerned the calculation of the approval majorities. Whereas the Commercial Court of Barcelona has repeatedly held that these majorities must be calculated on the basis of the *affected* financial claims only (e.g. in *FCC*<sup>408</sup> and *Comsa*<sup>409</sup>), the Seville court ruled that the majority thresholds refer to the total financial debt. Although it is too early to say that the Court of Seville definitively resolved this issue, the importance of its ruling in *Abengoa* may however not be underestimated as Abengoa's debt restructuring is by far the largest Spain has seen since the introduction of the Spanish Scheme.

Though the court initially dismissed the objections of the minority creditors at the homologation meeting, some of its creditors nonetheless successfully challenged the scheme on the grounds that they were disproportionately disadvantaged by it due to the difference in treatment of supporting and dissentient lenders in terms of haircuts, term extensions and interests.<sup>410</sup>

– *Isolux-Corsan*

The Madrid-based engineering company, Grupo Isolux Corsan SA, achieved creditor approval for a 2.2 billion USD debt restructuring plan. The company received backing from almost 90% of its creditors and requested the court to extend the terms of the plan to the other bondholders.

In concrete terms, the proposal set forth three debt tranches: 200 million EUR of new finance (tranche A); 550 million EUR, which was considered as sustainable debt in accordance with the Group's capacity to generate cash (tranche B); and approximately 1.4 billion EUR, which would be converted into equity, giving these creditors 95% of the company's shares, whilst diluting the shareholding of the existing shareholders to a sheer 5% (tranche C).

Isolux successfully sought homologation of its refinancing agreement in the second half of 2016. Unfortunately, the engineering group could not live up to its obligations under the restructuring

<sup>405</sup> Auto del Juzgado de lo Mercantil no. 2 de Sevilla, 360/2016, de 6 de abril de 2016, JUR 2016\75878; Sentencia Civil no. 442/2017, Juzgados de lo Mercantil - Sevilla, Sección 2, Rec 1142/2016 de 25 de septiembre de 2017.

<sup>406</sup> In the present case, however, the court found that no claim was contingent due to the fact that Abengoa filed for a pre-insolvency notice in accordance with art. 5*bis* LC, which triggered a default clause owing to which the claims concerned became due and payable.

<sup>407</sup> The cramdown of contingent creditors, *i.e.* persons who may be owed money by the company if a certain event occurs, has long been subject to debate in Spain. In this respect, the Commercial Court of Seville ruled that contingent claims could not be compromised under a Spanish Scheme on the grounds that contingent creditors cannot be considered "*holders of financial liabilities*" within the meaning of AP4 and are therefore excluded from voting. Extending the effects of the restructuring agreement to them would entail depriving them from present procedural rights while imposing substantive future obligations on them. The Commercial Courts of Barcelona and Seville therefore ruled that the agreed restructuring terms could not be extended to them as they do not have the opportunity to vote on the agreement either (*cf.* Sentencia Civil Juzgados de lo Mercantil – Barcelona, Sección 10, Rec 286/2016 de 29 de noviembre de 2016; Sentencia Civil no. 442/2017, Juzgados de lo Mercantil - Sevilla, Sección 2, Rec 1142/2016 de 25 de septiembre de 2017.).

<sup>408</sup> Sentencia Civil Juzgados de lo Mercantil – Barcelona, Sección 10, Rec 286/2016 de 29 de Noviembre de 2016.

<sup>409</sup> Auto del Juzgado de lo Mercantil no 8 de Barcelona, 69/2017-E, de 9 de febrero de 2017, BOE 31.7.2018, 49825.

<sup>410</sup> Sentencia Civil no. 442/2017, Juzgados de lo Mercantil - Sevilla, Sección 2, Rec 1142/2016 de 25 de septiembre de 2017.

plan, eventually ending up in *concurso* during which the Spanish business unit was transferred to incumbent directors.

Although the Spanish Scheme procedure is open to all types of (corporate) debtors, it is clear that it has mainly been used by mid to large businesses.<sup>411</sup> In fact, this mechanism has been used in a number of high profile cases in the past years, which urges the final question whether they constitute a more attractive alternative to the English schemes of arrangement.

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<sup>411</sup> Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 European Company and Financial Law Review 516, 525.

## D. COMPARATIVE ANALYSIS

### §1. Observations

To briefly summarize, the Spanish Scheme or '*acuerdo de refinanciación homologado*' is a clawback-protected collective refinancing agreement that is made binding through court homologation on non-participating creditors. It is a court-sanctioned restructuring process, which means that no insolvency representative is appointed (debtor-in-possession) and court involvement is limited to (i) the decision on the commencement of the negotiation period under 5*bis* LC (optional)<sup>412</sup> and (ii) the homologation of the refinancing agreement.

At present, the Spanish Scheme first requires the approval of creditors representing at least 51 % of the debtor's financial debt in order to benefit from clawback protection and incentivize the extension of new finance.<sup>413</sup> Secondly, and more importantly in the light of this study, it also allows for both unsecured and secured creditors to be "crammed down", meaning that dissenting and holdout creditors will be equally bound to the effects of the refinancing agreement, if higher creditor approval majorities are met.

Since its enactment in 2011, the Spanish Scheme has known a continuous development through legislative reforms and precedent-setting by the courts. Whether it already entails a full-fledge, commercially interesting and debtor-oriented scheme procedure like the English scheme of arrangement, is the research question of this article. In order to answer it in a nuanced and informed manner, a comparison between both out-of-court restructuring procedures will be made hereinafter, followed by some concluding remarks on the specific features of each procedure and their impact on the workability of each scheme in practice.

**Table IV: Comparative overview**

	Schemes of Arrangement	Spanish Scheme
<b>Legal basis</b>	Section 895 et seq. of the Companies' Act of 2006	Additional Provision 4 <i>juncto</i> Art. 71 <i>bis</i> of the Spanish Insolvency Act 22/2003, of July 9, 2003.
<b>Creditors</b>	"anyone who has a monetary claim against the company that, when payable, will constitute a debt" ( <i>cf.</i> Lehman Brothers International case), <i>i.e.</i> including contingent creditors.	"[t]he holders of financial claims, independently of whether they are supervised or not, excluding creditors that hold labour claims, claims originated in commercial transactions and claims subject to public law" (AP4 §1, para 3 LC), excluding also contingent creditors ( <i>cf.</i> the recent Abengoa case).

<sup>412</sup> Debtors have the possibility to formally notify the court of the commencement of their negotiations with their creditors in order to obtain an enforcement stay during the period that lapses from this pre-insolvency filing until the sanctioning hearing before the court. In any case, as from the petition to homologate the plan till the issuance of the decision, the scheming company enjoys absolute protection against enforcement actions brought by its creditors (AP4 §6 LC).

<sup>413</sup> or 3/5 of the company's total debt in accordance with Article 71*bis* LC.



## COMPARISON

	Schemes of Arrangement	Spanish Scheme
<b>Content</b>	<p>"<i>compromise or arrangement</i>" (cf. s.895 CA 2006):</p> <ul style="list-style-type: none"> <li>– interpreted widely ;</li> <li>– some element of 'give and take' ;</li> </ul>	<p>"<i>at least significantly increase the amount of available credit, amend, or terminate credit obligations by extending the due date or establishing other obligations to re-place the former, provided they are based on a viability plan that allows the company's ongoing activity in the short and medium term.</i>" (cf. Art. 71bis LC as referred to in AP4 §1 LC) :</p> <ul style="list-style-type: none"> <li>– interpreted narrowly as regards the terms that can be extended to non-participating creditors ;</li> <li>– e.g. no change of debtor or cancellation of security</li> </ul>
<b>Moratorium</b>	No statutory moratorium, notwithstanding r.3.1(2)(f) Civil Procedure Rules (cf. Vietnam Shipbuilding case)	<p>Article 5bis LC ('Pre-insolvency notice'), i.e. a 4-month (3+1) negotiation period:</p> <ul style="list-style-type: none"> <li>– no (involuntary) insolvency petitions by creditors ;</li> <li>– no enforcement against the debtor's assets, except (i) if the collateral is not necessary for the continuation of the business, (ii) enforcement by public creditors (taxes, social security, etc.), and (iii) assets located outside of Spain.</li> <li>– Stay of enforcement of financial claims if creditors representing at least 51% of the total financial debt expressly support the commencement of negotiations.</li> </ul>
<b>Majorities - Effects</b>	Approval by a majority in number representing at least 75% in value of the (class of) creditors, present and voting either in person or by proxy at the creditors' meeting (s.899 CA 2006).	<p>Depending on the nature of the financial claim (AP4 §3-4 LC) :</p> <p><b>Unsecured claims:</b></p> <p>60% approval of financial debt: moratoria of &lt; 5 years, conversion debt into PPL in 5 years ;</p> <p>75% approval of financial debt: moratoria of 5-10 years, haircuts (unlimited), debt-equity swaps, transformation of debt into ranking financial instruments, different maturity or conditions concerning the original debt, assignments in payment.</p> <p><b>Secured claims</b> (up to the secured amount):</p> <p>65% approval of secured financial debt: moratoria of &lt; 5 years, conversion debt into PPL in 5 years ;</p> <p>80% approval of secured financial debt: moratoria of 5-10 years, haircuts (unlimited), debt-equity swaps, transformation of debt into ranking financial instruments, different maturity or conditions concerning the original debt and assignments in payment.</p> <p>Secured claims that exceed the value of their collateral will be treated as unsecured claims for the non-covered amount.</p>

## COMPARISON

	Schemes of Arrangement	Spanish Scheme
<b>Classes of Creditors</b>	<p>Requirement to separate different classes of creditors (cf. Section 895 (1) CA 2006):</p> <p>A '<i>class of creditors</i>' consists of creditors whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. (cf. <i>Sovereign Life Assurance</i> case).</p>	No voting in "classes" ; the only determining criteria in the AP4 §3-4 LC is the existence of collateral securing the creditor's claim (e.g. the existence of subordination agreements is not taken into account)
<b>Court Involvement</b>	Court intervention is limited to (i) the application and directions hearing on the composition of the different creditor classes; and (ii) the sanction meeting during which the court decides on the homologation of the scheme.	Court intervention is limited to (i) the commencement of the negotiation period ex art. 5bis LC, if formally notified to the court (optional) and (ii) the homologation of the restructuring agreement.
<b>Challenge</b>	<p>No possibility for dissenting creditors to challenge the scheme (except in case of fraud).</p> <p>The interests of minority creditors are considered at the sanction meeting before the Court, during which the court will examine whether:</p> <p>(i) the statutory provisions have been complied with (e.g. explanatory statement), (ii) the majority approving the scheme fairly represents the class, and (iii) a reasonable person would approve the scheme.</p>	<p>Dissenting creditors have a 15-day term to challenge the scheme.</p> <p>The challenge will be successful and the homologation of the scheme will be revoked if:</p> <p>(i) the required majority has not been obtained or properly calculated; or (ii) if it imposes a '<i>disproportionate sacrifice</i>' on the challenging creditor.</p>
<b>Cross-class Cramdown</b>	<p>Theoretically speaking, a cramdown is only possible <i>within</i> creditor classes.</p> <p>However, a company can freely choose who to include in its restructuring plan and need not to include creditors whose rights remain unaffected by the sanction of the scheme. Creditors whose claims will remain unpaid if the company's assets would be liquidated (e.g. junior creditors and shareholders), will be considered 'out of the money' and deemed to remain unaffected by the sanction of the scheme, allowing in certain circumstances the cramdown of such creditors.</p>	<p>As described above, the LC does not require an applicant-debtor to separate its creditors into classes.</p> <p>The only criteria taken into account is the existence of collateral in order to qualify the creditor as secured or unsecured.</p> <p>Among unsecured creditors, no distinction is made between senior, junior and/or subordinated creditors, leaving some room for a de facto cross-cramdown.</p>
<b>Equity Cramdown</b>	Although there is no statutory mechanism providing for the cramdown of equity, objections of shareholders are unlikely to hold much weight as they will have no economic interest whatsoever in a balance sheet insolvent restructuring and will be unable to demonstrate that the scheme unfairly prejudices them (see <i>supra</i> 'Cross-class Cramdown').	A debt-for-equity swap must under any circumstances be approved by the majority of shareholders (50% +1) at the general shareholders' meeting. (AP4 §3 b 3° ii) LC)
<b>Third Party Releases</b>	Possible, if the creditor's rights against the third party are sufficiently closely connected with its rights as creditor vis-à-vis the debtor-company and provided that the release is necessary to give effect to the arrangement between the company and its creditors (cf. <i>La Seda</i> case)	Creditors included in a Spanish Scheme retain their rights vis-à-vis the guarantors and other parties that are jointly and severally obliged with the applicant-debtor (AP4 §9 LC)

## COMPARISON

	Schemes of Arrangement	Spanish Scheme
<b>International Effectiveness</b>	<p>The scheme of arrangement is not an insolvency proceeding in the sense of the (recast) EIR and therefore does not enjoy automatic recognition ex Article 32 (recast) EIR.</p> <p>Whether the English scheme entails a '<i>judgment</i>' for the purpose of recognition under Article 36 of the (recast) EJR has been successfully advocated in the past, but still remains uncertain to date (<i>cf.</i> Equitable Life case) and is likely to be overruled by Brexit.</p> <p>Alternative grounds for recognition have been found in the Rome Convention on contractual obligations and in the national conflict-of-law rules of the jurisdiction in which recognition was sought.</p>	<p>Both the Spanish Scheme procedure of AP4 LC, as well as the pre-insolvency filing for a negotiation period of article 5<i>bis</i> LC are included in Annex A to the (recast) EIR as a result of which they are both considered to be insolvency proceedings within the sense of Article 2 (recast) EIR.</p> <p>As a result, they will benefit from automatic recognition across the EU pursuant to Article 32 (recast) EIR.</p>
<b>Court Experience</b>	Many years of experience in bankruptcy cases and a business-oriented and rescue-enhancing approach.	The increase in and magnitude of the applications for Spanish Scheme proceedings allows the initially inexperienced Spanish judges to gain more experience in business rescue.
<b>Timeline</b>	On average, the time that lapses from the application until the sanction meeting is about 8-10 weeks. However, the length of the procedure and timing largely depends on how long it takes the debtor to separate the different creditor classes.	The ruling for approval of the refinancing agreement will be handed down through urgent proceedings within 15 days, and will be published in an announcement in the Public Insolvency Register and in the Official Gazette of the Spanish State. (AP4 §6 LC)
<b>Formal requirements</b>	<p>explanatory statement: every notice sent out summoning the creditor meetings must be accompanied by a statement explaining the effects of the proposed scheme (s.897 CA 2006)</p> <p>practice statement letter: sent out to all creditors in advance of the application and will typically include all details of the proposed scheme (i.e. background, purpose, timeline, the composition of the classes, etc.)</p>	<p>auditor certificate: stating that there are enough consenting creditors for the agreement to be adopted. (AP4 §2 LC)</p> <p>viability plan: allowing the continuity of the business activity in the short and medium term. (Art. 71<i>bis</i> LC)</p> <p>form: public deed. (Art. 71<i>bis</i> LC)</p>
<b>Filing</b>	Anytime	Anytime (5 <i>bis</i> §2 LC)

Conclusively, the *homologacion judicial de acuerdos financieros* or 'Spanish Scheme' now includes many features that initially incentivized Spanish companies to shop for an English scheme of arrangement in the past - most notably the cramdown of secured creditors.<sup>414</sup> As a result, the Spanish Scheme can nowadays rightly be considered a full grown and effective tool for Spanish debtors to restructure their debt.

<sup>414</sup> Iñigo de Luisa and Ignacio Buil Aldana, 'Spain: Reworking the Spanish Scheme' (International Financial Law Review, March 2014) <<http://www.iflr.com/Article/3322780/Spain-Reworking-the-Spanish-scheme.html>> accessed 17 February 2019; Beatriz Rúa, 'Approach to Spanish insolvency framework after 2014's amendments' (2015) 28(4) Insolvency Intelligence 56, 56.

## §2. Impact

Whether the Spanish Scheme is able to compete with its English equivalent is to be assessed taking the impact of the specific features compared above into account:

- **Legal basis:** The perception as regards the statutory basis of both procedures should not be underestimated. Being part of Spain's insolvency legislation and being officially recognized as an insolvency proceeding by the (recast) EIR, undoubtedly has some negative consequences in terms of perception. As discussed above, Spain's entrepreneurial culture is still suspicious with (pre-)insolvency procedures and negative preconceptions, stemming from the *pre-LC* era, are still strongly embedded in the collective memory of the business community, leading to bad publicity and unease among creditors, suppliers and customers to the detriment of the company's business.

The scheme of arrangement, on the other hand, is regulated by the Companies' Act of 2006 and is not particularly associated with insolvency, as it has been used for a variety of solvent purposes as well (e.g. takeovers).<sup>415</sup>

Depending on (the publicity-sensitivity of) the sector in which the debtor is active, the so-called 'insolvency stigma' might play an important role and still urge companies to turn to foreign scheme procedures that are not formally linked to insolvency such as the English scheme of arrangement.

- **Creditors:** Although the amendment of the personal scope of the AP4 from 'financial entities' (*entidades financieras*) to 'holders of financial liabilities' (*los pasivos financieros titularidad de acreedores*) significantly widened its reach, including now also bondholders for instance, the Spanish Scheme procedure still not allows for trade creditors, social creditors and public creditors to be crammed down.<sup>416</sup>

This means that the effects of the homologated restructuring agreement cannot be extended to, inter alia, (dissenting) suppliers, tax authorities and the social security administration. Compared to the s.895 CA 2006 which does not exclude any creditors, this is regrettable from an overall, comprehensive restructuring perspective.

- **Content:** Whereas the restructuring options under a scheme of arrangement are practically unlimited provided that there is some element of 'give and take', the AP4 §3-4 LC contains a list of restructuring measures, but does not specify whether this list is exhaustive or not. Contradictory rulings have been handed down in this regard.<sup>417</sup> Unfortunately, in most cases Spanish courts have interpreted the text of the AP4 LC in a restrictive manner.

Consequently, in some complex, multi-tiered restructuring scenarios the options available to the debtor or enterprise group under Spain's *homologacion judicial* might be insufficient, e.g. where a change of debtor or cancellation of security is required.

<sup>415</sup> See *supra* '2.2.5.1 No Stigma' (Part B: English Scheme of Arrangement).

<sup>416</sup> AP4 §1 LC: "*Quedan excluidos de tal concepto los acreedores por créditos laborales, los acreedores por operaciones comerciales y los acreedores de pasivos de derecho público*" (freely translated: "This concept excludes creditors holding labour claims, creditors with claims resulting from commercial transactions and public creditors.") In other words, for a claim to be financial it should stem from a financing contract that involves extension of funds to the debtor. It would not be a broad concept but, rather, a restrictive one. Other forms of credit, such as instalments of commercial contracts or credit insurance to obtain better payment conditions from suppliers, would not count. The delivery of cash would be a requirement thereof. On the other hand, not every monetary claim should be characterised as a financial claim. For a monetary claim to be financial, a repayment obligation under a financial agreement should exist.

<sup>417</sup> Carlos Nieto, 'Judicial consideration of the Schemes of Arrangement' (2016) Eurofenix 42.

However, the progressive decision of the Commercial Court of Madrid in relation to the restructuring of the cosmetics company Bodybell by which it held that in certain circumstances in rem security can be cancelled may have opened the door for more inventive restructuring terms that are not per se included in AP4 LC.<sup>418</sup>

- **Moratorium:** The pre-insolvency filing for a negotiation period under article 5*bis* LC holds a significant advantage of the Spanish Scheme over the English scheme of arrangement, which does not by statute foresee a stay of enforcement.

This lack of moratorium has many times been criticized as one of the foremost weaknesses of the English scheme.<sup>419</sup> However, the English courts have been able to overcome this weakness in the past by exercising their discretion to grant a stay of execution under r. 3.1.(2)(f) Civil Procedure Rules pending consideration of a proposed scheme with a reasonable prospect of success.<sup>420</sup>

Nonetheless, for Spanish debtors with most of their assets and creditors located in Spain this statutory moratorium might very well be a decisive element to file for a Spanish instead of an English Scheme, especially because article 5*bis* LC falls within the scope of the (recast) EIR and therefore enjoys EU-wide recognition (see *infra* 'Recognition').

- **Effects - Majorities:** Unlike the generally applicable 75% threshold required for the sanctioning of an English scheme, the *homologacion judicial* prescribes different majorities depending on (i) the effects envisaged by the scheme, and (ii) the type of creditors (secured or unsecured) it seeks to bind. In other words, the majorities required are directly proportional to the hardship of the measures included.<sup>421</sup>

Though the general 75% threshold as provided by s.895 CA 2006 generally does not lead to any difficulties in practice - especially since there is no quorum requirement -, the fact that "*a majority in number*" is also required, i.e. the so-called headcount test, is undoubtedly a flaw of the English scheme of arrangement. It enables a large number of creditors with only a very small aggregate debt amount to overpower a company's major creditors in value (e.g. banks) and even to block a scheme. It goes without saying that this headcount requirement leaves room for abuse (e.g. debt splitting) and makes the English scheme vulnerable to dissenting minority creditors.

In Spain, the controversy primarily related to the calculation base of the cramdown majorities in AP4 LC. Some courts held the minority view that only *affected* debt could count for the calculation of these majorities (e.g. FCC and Comsa), whereas the strict reading of the law does not presuppose this. It appears for now that this discussion has been settled by the Court of Seville in *Abengoa*: the *total* financial debt, affected by the scheme or not, forms the calculation base for the AP4 majorities.

<sup>418</sup> Auto del Juzgado de lo Mercantil no 11 de Madrid, 760/2015, de 20 de Octubre de 2015, BOE 30.10.2015, 45335. See also supra '3.6 The Spanish Scheme: 4 years' practice' (Part C: Corporate Rescue in Spain).

<sup>419</sup> Company Law Review, *Modern Company Law for a Competitive Economy - Final Report*, URN 01/943, 2001 (CLR, Final Report), para 13.11. It is worth noting that the introduction of a statutory moratorium has been proposed by the Department for Business, Energy & Industrial Strategy and The Insolvency Service after its public consultation in 2018 (Department for Business, Energy & Industrial Strategy and The Insolvency Service, *Consultation on insolvency and corporate governance: government response* (Insolvency and Corporate Governance, 26 August 2018) 42 et seq. <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 24 February 2019).

<sup>420</sup> See *Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group and others* [2013] EWHC 1146 (Comm.) and *Sea Assets Ltd v. PT Garuda Indonesia*, 27 June 2001, unreported, as discussed in Gabriel Moss, 'Scheme of arrangement: a recent example' (2003) 16 (1) *Insolvency Intelligence* 6.

<sup>421</sup> If creditors representing at least 51% of the company's financial debt have approved the refinancing agreement, the homologation will only be protected against avoidance actions (clawback). In order to also extend its effects to non-participating creditors, higher majorities are required.

- **Creditors Classes:** Remarkably, the Spanish Scheme procedure knows no voting by ‘classes’. Although one might think that the absence of this categorization exercise - which is generally perceived as time-consuming and burdensome - smoothes the process, the formation of majorities in the Spanish Scheme procedure would be rigid, making it more difficult to reach an overall solution for a company's creditors. According to Tirado, this might be another element for creditors to force their debtor to restructure under the laws of England or Wales.<sup>422</sup> In this regard, Nieto also argues that the wording of AP4 LC is still uncertain as regards whether a difference in treatment should be made between different debt categories and whether different measures could be imposed asymmetrically.<sup>423</sup>

Needless to say, this inability of different ‘classes’ being formed by the debtor and the uncertainty about whether different restructuring measures could be imposed asymmetrically restricts corporate debtors in their freedom and creativity when formulating a restructuring plan.

Furthermore, whilst all rules that add certainty and speed to the process should be welcomed, it cannot be denied that due to the absence of ‘classes’, the protection of minority creditors will differ significantly in both schemes, especially because the English courts are also quite concerned with each creditor class being fairly represented at the creditors' meetings.

- **Cross-class cramdown:** It is clear from the above that both schemes, theoretically speaking, do not allow a cramdown *across* creditor classes. However, in certain circumstances a cross-class cramdown can very well be achieved in practice.

In Spain, the absence of actual “classes”<sup>424</sup> seems to leave some room for cramming down certain creditors, who would under the English scheme procedure be considered as a separate class. After all, a company's pool of unsecured creditors often consists of all kinds of creditors, who might rank differently in a subsequent liquidation scenario (e.g. subordinated creditors, ordinary creditors, preferential creditors, etc.). Whilst they might therefore not all be equally affected by the restructuring measures included in a scheme proposal, they will not be able to vote separately on the approval thereof and, as a result, might be in fact crammed down by other (unsecured) creditors with different interests in the company's restructuring. Besides, insofar as they are *undersecured*, i.e. to the amount that their claim exceeds the value of their collateral, even secured creditors can vote on the approval of restructuring measures extended to unsecured creditors.

Whereas in the UK, on the other hand, creditor classes are carefully delineated (cf. *Sovereign Life Assurance* case), debtors are generally free to choose with whom they enter into a restructuring scheme. As a consequence, scheme companies have successfully bypassed out-of-the-money creditors' dissent in the past by twinning a scheme with a pre-pack sale of the business to a NewCo, subsequently converting senior debt into new shares and leaving dissentient junior creditors in the old company with no assets left, hereby thus *de facto* cramming down these junior creditors (see *infra* ‘Equity Cramdown’).

Whether the question of ‘if’ and ‘how’ a *de facto* cross-class cramdown could be achieved under both scheme procedures will be of much relevance in the future, remains to be seen

<sup>422</sup> Ignacio Tirado, ‘Out of court Debt Restructuring in Spain. A Modernised Framework’ (2017) *European Company and Financial Law Review* 1, 24 <[www.law.ox.ac.uk/sites/files/oxlaw/tirado\\_modernised\\_framework.pdf](http://www.law.ox.ac.uk/sites/files/oxlaw/tirado_modernised_framework.pdf)> accessed 17 February 2019.

<sup>423</sup> Carlos Nieto, ‘Judicial consideration of the Schemes of Arrangement’ (2016) *Eurofenix* 42, 43.

<sup>424</sup> In the author's opinion, the (too) broad distinction between secured versus unsecured creditors does not facilitate the division of actual creditor classes as is the case under the English scheme procedure, wherein a ‘class’ consists of “*creditors whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest*” (*Sovereign Life Assurance* case).

given the initiatives at national (UK)<sup>425</sup> as well as supranational level (EU)<sup>426</sup> to legally enshrine a cross-class cramdown mechanism in both national jurisdictions.

- **Equity Cramdown:** For shareholders a conversion of debt into equity implies the dilution of their shares' value. Therefore, shareholders are often reluctant to agree to a debt-for-equity swap. The inability to cramdown equity has jeopardized many restructurings in the past, unfairly giving shareholders too much say in the restructuring process whereas their 'real' economic rights are usually reduced to zero in an insolvency scenario.

A number of measures have been introduced to facilitate debt-for-equity swaps in Spain such as, inter alia, reduced majorities and tax advantages. Most notably, since 2015 not only directors but also shareholders of a company be held liable for any shortfall for creditors within insolvency if they have been found guilty of causing or aggravating the insolvency of the company. With regard to the negotiation of a refinancing agreement, the article 165 §2 LC foresees a liability presumption "(...) *when shareholders or directors had rejected, without a justified cause, a capitalization of claims or the issuance of convertible securities, and such rejection had caused the frustration of a refinancing agreement (...)*". In other words, shareholders will either see their ownership rights in the company diluted or risk personal liability if things eventually go wrong.

Under part 26 of the CA 2006, an entire class of creditors or shareholders can in principle not be crammed down by the use of a scheme standalone. However, as mentioned earlier, a company is generally free to select the creditors with whom it wishes to conclude an arrangement and need not to include creditors whose rights are not altered by the scheme (*cf.* Garuda case). As a result, it has been successfully argued in the past that shareholders qualify as "out-of-the-money" creditors with no remaining economic interest in the company and therefore not need to be included in a scheme, which allows for a *de facto* cross-cramdown or - more accurate in the author's opinion - the disqualification of shareholders (e.g. Tea Corporation case). A practical illustration of such 'disqualification' is the IMO Carwash group restructuring wherein a debt-for-equity swap was implemented by first transferring the group's assets to a NewCo (pre-pack sale) followed by the conversion of senior debt into shares of the NewCo through a scheme, leaving the shareholders in the old shell company with no assets left. The court found that the 'abandoned' stakeholders had no remaining economic interest in the company and sanctioned the scheme.

In short, both scheme procedures allow to a certain extent for a *de facto* equity cramdown, either on the basis of case law regarding the disqualification of out-of-the-money creditors, or through the threat of personal liability. Whether this recently introduced 'stick' of art. 165 §2 LC will be equally effective to cramdown equity, remains to be seen. At present, to some scholars this liability risk seems quite far-reaching, especially in light of the removal of the (imminent) insolvency condition in Article 71*bis* LC,<sup>427</sup> whereas others argue that this attempt to obtain an effect equivalent to an equity cramdown has been unsatisfactory in practice (e.g. Pescanova case).<sup>428</sup>

<sup>425</sup> Department for Business, Energy & Industrial Strategy and The Insolvency Service, *Consultation on insolvency and corporate governance: government response* (Insolvency and Corporate Governance, 26 August 2018) 63 et seq. <<https://www.gov.uk/government/consultations/insolvency-and-corporate-governance>> accessed 24 February 2019.

<sup>426</sup> Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM/2016/0723 final - 2016/0359 COD), Article 11 available at <<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN>> accessed 20 February 2019.

<sup>427</sup> Ignacio Tirado, 'Out of court Debt Restructuring in Spain. A Modernised Framework' (2017) *European Company and Financial Law Review* 1, 25 <[www.law.ox.ac.uk/sites/files/oxlaw/tirado\\_modernised\\_framework.pdf](http://www.law.ox.ac.uk/sites/files/oxlaw/tirado_modernised_framework.pdf)> accessed 17 February 2019.

<sup>428</sup> Adrian Thery, 'Crossroads in EU Harmonization on restructuring and insolvency: Towards a marked-based model or one where "the senior takes it all"?' (2016) 1 *Revue Trimestrielle de Droit Financier* 21, 22.

- **Third party releases:** Whereas it is settled case law that claims against third parties can be released in a English scheme procedure under certain circumstances, creditors crammed down at the level of the principal debtor by a Spanish Scheme retain their rights vis-à-vis joint-obligors and guarantors. Consequently, under Spanish law each creditor in whose favor the third party has provided the guarantee has to give its consent in order for the release to extend to the guarantor.<sup>429</sup>

To counter this inconvenience, Spanish Schemes are often 'group schemes', whereby not only the principal debtor, but also its affiliated companies and subsidiaries that are obligors or guarantors of some of its debt jointly file for homologation for the purpose of extending the effects of the scheme to their relation vis-à-vis these creditors (e.g. the petition of Abengoa involved 46 group companies).<sup>430</sup>

Although these Spanish 'group schemes' are not ideal considering the increased numbers of stakeholders to take into account, there are also still some unresolved issues concerning the release of third party claims under an English scheme (e.g. with regard to the necessity of a release for the success of the scheme)<sup>431</sup>. Additionally, in the *La Seda* restructuring, i.e. the leading case whereby third party claims were released, the documents underpinning the claims were governed by English law.<sup>432</sup> With regard to the recognition of such a release abroad, it can be questioned whether the Spanish courts would take the same approach in the event of, for instance, Spanish law-governed guarantees being released.

Conclusively, having regard to the potential recognition issues in relation to third party releases under an English scheme, especially in light of the forthcoming Brexit, Spanish enterprise groups might want to opt for certainty and prefer a group scheme under AP4 LC instead.

- **Experience:** Although the completion of a restructuring plan under both schemes largely takes place outside the court, the role of the courts is not to be underestimated, as they eventually have to decide on the homologation of the agreement.

Whilst initial data showed that Spanish courts were not particularly skilled and relatively inexperienced given the low amount of bankruptcy cases in the last decade, the increase in applications for Spanish schemes since 2014 has led to more experienced judges and the establishment of more specialised courts across Spain.<sup>433</sup>

Also in view of the magnitude of the scheme applications (e.g. Abengoa), it is likely to be just a matter of time before Spanish courts are as familiar with these court-sanctioned restructuring agreements as the English judges who are praised for their rescue-oriented approach.

- **Challenge:** Unlike the English scheme of arrangement, which, if sanctioned, is final (except in case of fraud), creditors have a 15-day term to challenge the homologation of a Spanish Scheme. Albeit the grounds to do so are limited - i.e. the required majorities have not been achieved or certain creditors suffer a "*disproportionate sacrifice*" -, especially the latter causes grave uncertainty due to its vagueness.

<sup>429</sup> See also Michael Veder and Adrian Théry, 'The release of third party guarantees in pre-insolvency restructuring plans' in Bas Kortmann, Dennis Faber, Ben Schuijling, Niels Vermunt (eds), *Trust and good faith across borders, Liber amicorum* (Deventer - Wolters Kluwer 2017), 259-274.

<sup>430</sup> Auto del Juzgado de lo Mercantil no. 2 de Sevilla, 360/2016, de 6 de Abril de 2016, JUR 2016\75878.

<sup>431</sup> Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2nd edn, Sweet and Maxwell 2017) 158-160.

<sup>432</sup> *Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch); [2011] 1 BCLC 555. See also *Re T&N Ltd (No. 3)* [2006] EWHC 1447 (Ch); [2007] 1 All ER 851.

<sup>433</sup> See *supra* '1.3.2.5 Lack of Expertise' (Part C: Corporate Rescue in Spain).



In practice, however, debtors should not be too concerned with their scheme being challenged. First, the proportionality and the necessity of the restructuring terms are usually assessed against the finality of the viability plan<sup>434</sup>, which in itself cannot be subject to challenge. Secondly, a challenge can only be brought before the same court. This undeniably reduces the chances that a scheme will be reconsidered. Nonetheless, in the recent Abengoa case the Court of Seville upheld the challenge and revoked its own endorsement.

The English court, on the other hand, will assess - apart from the formal requirements of s.895-901 CA 2006 - whether the scheme is reasonable and makes "business sense" at an earlier stage, i.e. at the sanction meeting. At this stage, the court will also check whether its effects are fair and equitable particularly having regard to the economic interests of each creditor (class) concerned.<sup>435</sup>

- **Recognition:** In relation to both scheme procedures, the cross-border element is evidently of great relevance considering the type of debtors that often use these out-of-court restructuring procedures, *i.e.* large multinational groups.<sup>436</sup> As is clear from the above, large restructuring operations may be hampered by the uncertainty concerning the recognition of their effects abroad.

Even leaving Brexit aside, the difference between both schemes as regards their effectiveness abroad could not be more significant. Whereas Spain's scheme proceedings automatically benefit from recognition in all EU Member States (Art. 32 recast EIR), foreign recognition of English schemes has often been the result of trial and error and still remains uncertain to date due to its absence in Annex A to the (recast) EIR and its doubtful compatibility with the concept "judgment" within the meaning of the (recast) EJR (e.g. Equitable Life case).

Notwithstanding the fact that recognition of English schemes has been successfully sought under national – and also Spain's – conflict-of-law rules and that the ROME I will not cease to apply as a result of Brexit, the UK leaving the EU in March 2019 will undeniably add to this uncertainty and might encourage Spanish companies to turn to more stable, local alternatives such as the Spanish Scheme, especially if the latter continues its march forward of the past years.

On a final note, it should be said that the fact that the English scheme does not fall under the auspices of the (recast) EIR also has a positive side - apart from not being stigmatized as 'insolvency procedure': whereas only a company with its COMI in Spain can file for a Spanish Scheme, the only criterion to be taken into account for being eligible to apply for an English scheme is the broadly construed concept of "sufficient connection". Particularly for cross-border debt restructurings involving more than one company, the ease wherewith jurisdiction can be established under the English procedure is in sharp contrast with its Spanish equivalent that would require the COMI of each company included to be located in Spain (see also *supra* 'Third party releases').

<sup>434</sup> When the *Abengoa* scheme got challenged, the Commercial Court of Seville ruled that the measures included in a scheme could constitute a disproportionate sacrifice, if they are unnecessary and exceed the real needs under the viability plan. In this case, the court held that a 97% reduction and 10-year rescheduling arrangements contained in the restructuring proposal that were imposed on the dissenting creditors were excessive from the point of view of the viability plan and therefore constituted a disproportionate sacrifice (Sentencia Civil no. 442/2017, Juzgados de lo Mercantil - Sevilla, Sección 2, Rec 1142/2016 de 25 de Septiembre de 2017).

<sup>435</sup> See *supra* '§1. General' (Part B: English Scheme of Arrangement).

<sup>436</sup> e.g. the restructuring of the Abengoa Group included 46 group companies (Auto del Juzgado de lo Mercantil no. 2 de Sevilla, 360/2016, de 6 de Abril de 2016, JUR 2016/75878).

### §3. Conclusion

Although it might be too soon - the Spanish Scheme as it currently stands being only 4-5 years in force now and God knows how long before Brexit - to predict whether or not the Spanish Scheme will keep large companies in distress from luring to more attractive scheme proceedings overseas, observations can nonetheless be made as regards its (in)efficiencies and the potential benefits companies may reap from the end result of the Spanish legislator's efforts.

For the past years, we have seen very large and well-known Spanish companies and conglomerates restructuring their debt through *homologacion judicial* proceedings (e.g., Celsa, FCC, Abengoa, Grupo Isolux-Corsán, Bodybell, etc.). From 2015 to early 2017, there have been around 200 successfully homologated Spanish Schemes, concerning over 600 (!) companies with only 24 debtors eventually ending up in *concurso*.<sup>437</sup> This is perhaps the best proof that the Spanish Scheme is finally fit for purpose. Since its introduction in 2011, it has been subject to a number of - necessary - reforms and many interpretative issues with regard to its scope (cf. 'financial liabilities') and its procedure (e.g. calculation of majorities) have been resolved by the Spanish Courts, as a result of which the framework is now better defined.

The most important changes that enabled the Spanish Scheme to become the well-equipped restructuring tool that it is today are, amongst others, the amendment/expansion of its personal scope from unsecured 'financial entities' to the more widely interpreted concept of 'holders of financial liabilities', regardless of whether their position is secured by any collateral or not; the extension of the moratorium of article 5*bis* LC to the pre-filing phase to allow debtors to negotiate a debt restructuring with their creditors without being bullied by individual enforcement actions or involuntary insolvency petitions; the introduction of new approval majorities for a restructuring agreement to benefit from clawback protection and to impose restructuring terms on dissenting creditors; the expansion of the range of "crammable" effects, adding more rescue-oriented measures such as, inter alia, debt-for-equity swaps to the list. Conclusively, whilst many Spanish companies traditionally looked to the flexibility and certainty of the English schemes of arrangement, it is clear that Spain now has a national scheme model of its own.

Although the Spanish Scheme is expected to continue its march forward, limitations still exist. Important creditors such as commercial, social and public creditors cannot be crammed down by it, nor can creditors' rights against guarantors and joint obligors be released or amended within the framework of this procedure (unless with individual consent of each creditor). It also only distinguishes secured from unsecured creditors without the possibility to establish more creditor classes based on the respective rights of the company's creditors and their actual ranking in the debt structure. This has been argued to make it more difficult to reach a tailor-made restructuring.

Ultimately, what the Spanish Scheme all the more needs is confidence from debtors and their creditors in the opportunities it provides and trust in the Spanish courts to enhance business rescue by means of precedent-setting, such as in the recent Abengoa case.

Overall, the author believes that the Spanish Scheme has evolved over time to become an efficient out-of-court restructuring tool, which can not only compete with, but also provide significant advantages compared to its English inspiration (e.g. moratorium). Undeniably, it suffered - and still suffers - from some teething problems, but it can nonetheless not be disregarded that Spain's restructuring practice has tackled many of these issues in recent times as a result of which the Spanish Scheme is now able to cope with today's insolvency risks and restructuring needs.

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<sup>437</sup> Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain.' (2018) 15 European Company and Financial Law Review 516, 535.

## CONCLUSION

Especially in light of debt restructurings of large companies located in Spain, the Spanish Scheme is expected to become the first restructuring means to be looked at by distressed debtors. Only in circumstances that require specific restructuring needs (e.g. release of third party claims), a scheme of arrangement might still distinguish itself from its continental European duplicates and once again prove its exquisite restructuring value.

However, it is important to keep in mind that the opening of an English scheme procedure does not benefit from automatic recognition in Spain and therefore dissenting creditors with recourse to assets located in Spain might still cause troubles in terms of security enforcement. Absent a COMI-shift, creditors would also retain the power to file for insolvency proceedings in Spain. In respect of companies with significant assets in Spain, also territorial proceedings could be opened in accordance with art. 3.2 (recast) EIR, hereby undermining the benefits of a global and comprehensive restructuring. Thereafter, once homologated, the recognition of an English scheme is also not a guarantee and is likely to become even more burdensome after Brexit.

What is more is that the proposed EU Directive on preventive restructuring frameworks amending Directive 2012/30/EU<sup>438</sup> is about to become law (presumably) in the course of 2019 and will require Member States, such as Spain, but probably no longer the UK due to Brexit, to incorporate effective preventive restructuring mechanisms into their internal legal systems to promote corporate rescue. In its final proposal<sup>439</sup>, the Council's focus is, *inter alia*, on the introduction of a mandatory stay of individual enforcement actions (max. 4 months with a possibility to extend the initial duration in case of particularly complex plans) and a cross-class cramdown mechanism of which the conditions will be set at national level. The Member States will also have to ensure that shareholders are not allowed to unreasonably prevent or create obstacles for the adoption and confirmation of a restructuring plan (*cf.* Spain's new shareholder liability in Art. 165 §2 LC to facilitate debt-for-equity swaps). It can therefore be expected that throughout Europe, and thus also in Spain, out-of-court business rescue mechanisms will be further enhanced following this trend of promoting corporate rescue.

Finally, to answer the research question of this study: at present, the grass on the other side is in itself hardly any greener, maybe a slightly other type of green. In any case, it remains to be seen how the lawn of the overseas neighbours will look after them moving out the area.

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<sup>438</sup> Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (COM/2016/0723 final - 2016/0359 COD), Article 11 available at <<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN>> accessed 20 February 2019.

<sup>439</sup> available at <https://data.consilium.europa.eu/doc/document/ST-15556-2018-INIT/en/pdf>.

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