Client Alert | Banking / Capital Markets

Ten things to consider when you do a leveraged finance deal in Spain

European Leveraged Finance Alert Series: Issue 6, 2018

June 2018

Authors: Yoko Takagi, Pedro Hendel

One: Regulatory framework for Lending in Spain

Lending in Spain is generally not considered a reserved activity for Spanish-licensed and EU-passported banks or financial institutions authorized by the Bank of Spain. Nevertheless, such financial institutions may have certain advantages, such as exemptions in terms of withholding taxes or the ability to create and enforce financial guarantees as per Royal Decree Law 5/2005 on urgent reforms to encourage, among others, productivity and improve public procurement ("RDL 5/2005") which implements the European Collateral Directive (Directive 2002/47 EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements) in Spain.

Two: Corporate Benefit

A Spanish company must derive a benefit from any transaction it enters into. Under Spanish law, a company is required to use its assets and credit to further its own corporate purposes and for its own benefit. Therefore, the granting of an up-stream/cross-stream or even down-stream guarantee by a Spanish company may violate this rule if that company cannot prove that it obtains a benefit from the guarantee. The determination of whether a particular transaction (*e.g.*, granting of a guarantee) complies with such requirement is a factual matter to be determined by the directors. This assessment needs to be made on a case by case basis, analyzing all circumstances pertaining to the transaction (*e.g.*, type, size, purpose, structure of the group, *etc.*). Directors of Spanish companies have to comply with fiduciary duties (namely the duties of loyalty and care) when performing their obligations, including the approval of such transactions. Directors may be liable and exposed to sanctions and claims for failure to comply with this requirement. Often times certain limitation language is included in the finance documents and in the corporate resolutions with the aim to contractually limit the guarantee obligations of the Spanish company/guarantor to an amount equal to the amount of the proceeds of the guaranteed parent/sister company debt (whether under a facility or debt securities) that is directly or indirectly on-lent to that guarantor by the parent/sister company borrower under intra-group loans.

Three: Financial Assistance

Spanish corporate law places restrictions on Spanish limited liability companies (*sociedades de responsabilidad limitada* (SRLs) and *sociedades anónimas* (SAs)) granting financing assistance, generally, to acquire its own shares or those of companies within its group. The financial assistance extends not only to providing financing, advancing funds and granting loans, but also to granting security interests or guarantees of debt incurred by a third party, or participating or assisting in any manner that contributes to the purchase of the shares of that company or of its parent company (in the case of SAs) or of any of the group companies (in the case of SRLs). Any financing, guarantee, security, *etc.* created in breach of such rules will be considered null and void and may raise liabilities for the directors of the directors of the companies involved.

There are no whitewash mechanisms available under Spanish law (other than as described hereunder) and the refinancing of any acquisition finance does not cure any previous financial assistance breaches.

It used to be market practice that, in leverage finance transactions, a forward merger was effected as a means to avoid the application of the financial assistance rules. However, such practice has been somewhat limited

in recent years by the application of the Corporate Structural Modifications Law, which provides that in case of a merger of companies where any of them has incurred debt, in the three years preceding the merger, in order to gain control over any of the other companies involved in the merger or to acquire any of their essential assets required to operate in the ordinary course of their business or assets which are relevant in terms of the equity value, certain requirements need to be complied with. Such requirements include an independent expert report determining whether there had been financial assistance.

Four: Parallel Debt and Security Trustees

Spanish law does not envisage parallel debt schemes where "parallel obligations" which mirror the obligations of the underlying debt owed by such borrower/issuer are created in favor of the security agent for the same amount and payable at the same time as the underlying debt. Similarly, the concept of a trust, and therefore, of trustees, is not regulated under Spanish law. The reason for this is that security rights under Spanish law need to be based on a legitimate reason and are considered as "accessory" or "ancillary" in nature to the principal obligation. This means that the validity, enforceability and scope of the security rights is strictly linked to the existence and scope of the rights of the holder of the principal obligation (whether under a facility or debt securities). Therefore, in order for the lenders in a syndicated loan to be direct beneficiaries of any security interest, they should be parties to the Spanish security documents (either directly or duly represented by the security agent). Such authorization is, in most instances, effected by means of a power of attorney granted by each of the lenders which should be notarized in their home countries and apostilled.

Five: Approval of Finance Transactions

Entering into finance transactions (which do not involved issuing securities) by limited liability companies (SAs or SRLs) are usually considered in Spain to be actions performed in the ordinary course of business. Hence, Spanish regulation does not normally require approval from the shareholders of the company. As an exception to this rule, approval will be required when: (i) such actions are excluded or not envisaged in the corporate purpose of the company; (ii) expressly required by the by-laws of the company; (iii) required by the finance parties; (iv) in the case of SRLs, if such guarantee is granted in favor of its shareholders or directors; or (v) if the security is granted over assets that are essential for the company. There is a presumption that the creation of a security interest over assets representing over 25 percent of the assets of the company is material, and therefore requires such approval.

Six: Bankruptcy Claw-back and Guarantees

Any guarantee of any nature (including up and downstream, as well as cross-stream or *in rem* securities) given or granted by a Spanish company can be subject to claw-back provisions where the guarantor or grantor of such guarantee or security interest becomes insolvent. The claw-back period extends for a period of two years from the granting of such interest. Such claw-back action will only succeed to the extent the claimant (*e.g.*, creditor to the insolvent company or insolvency receiver) can prove that such action was detrimental for the estate of the insolvent company. For obvious reasons, proving the existence of benefits for a company in case of cross-stream and upstream guarantees is more challenging than of a downstream guarantee and may be disputed.

Transactions (including any security interests) entered into or granted as part of refinancing transactions effected as per articles 71bis and Additional Provision 4 of the Spanish Insolvency Act are not subject to such claw-back actions (the "Protected Refinancing Schemes"). These schemes are debt restructuring plans, conducted on a private basis but approved by the Spanish courts.

Seven: Subordination

Under Spanish law, a credit right may be subordinated as a consequence of an agreement or by operation of law. According to the Spanish Insolvency Act, a specially related party debt shall be considered as subordinated debt.

Such related parties include, among others: (i) shareholders of at least five percent of the share capital of the debtor (in the case of listed companies) or ten percent of the share capital (for non-listed companies); (ii) directors, liquidators and representatives with general powers of the debtor, as well as those who have acted as such during the two years preceding the declaration of insolvency (for these purposes the concept of director extends not only to legally appointed directors but also those considered *de facto* directors); and (iii) companies forming part of the same group as the insolvent company and their "common shareholders."

It is worth noting, though, that creditors who hold shares/equity as a consequence of one of the Protected Refinancing Schemes are not deemed specially related persons as a result of such refinancing.

Eight: Collateral in Spanish Security Interests

Security in Spain needs to be taken on an asset-by-asset basis. In Spanish leveraged finance transactions, the most commonly taken security is over shares (and other securities), receivables and bank accounts. Other assets (including intellectual property, inventory or ongoing business) can also be included in the security package on a case-by-case basis.

Security in Spanish real estate can be expensive due to stamp duty levied on the amount secured by the mortgage. Therefore, a more common practice is for promissory mortgages to be created. This arrangement does not create an *in rem* security interest, but rather an undertaking to create a mortgage upon the occurrence of any of the situations or circumstances agreed to by the lenders and debtor.

Perfection formalities (*e.g.*, dispossession of the pledged asset, registration and notification) will depend on the type of security interest and the nature of the pledged asset. In most instances, public deeds executed before Spanish public notaries are required, as well as, in certain cases, registration with the relevant registries. Should such registration be required the security document will need to be drafted or translated into Spanish and taxes are payable levied on the secured amount.

It is common that irrevocable powers of attorney are granted in favor of the security agent to effect certain actions on behalf of the grantor of the security in relation to such security. The type of actions covered by this power of attorney are usually related to the perfection of the security interest, and it is intended to be used only in cases when the grantor refuses to perform such actions and, therefore, the lenders' rights might be jeopardized. This power of attorney must be granted in a public deed before a Spanish public notary.

Nine: Enforcement and Prohibition of Appropriation (*Pacto Comisorio*)

There is a general prohibition in Spain, enshrined in article 1859 of the Spanish Civil Code, whereby a secured party cannot appropriate or directly dispose of the asset given as collateral (*pacto comisorio*). As a result, the beneficiaries of the security must initiate enforcement proceedings in order to obtain the sale of the asset and only then use the proceeds as repayment of the secured debt.

Despite this prohibition, RDL 5/2005 allows for the direct sale or appropriation of the pledged assets. However, this exception only applies to guarantees in favor of financial institutions, as defined in Directive 2006/48 of the European Parliament and of the Council of 14 June 2006 relating to the taking and pursuit of credit institutions, and the pledge assets must be cash, marketable securities or other financial instruments.

Ten: The Catalonian Regulation

To the extent the pledged assets are located in Catalonia, the Catalonian Civil Code applies (Act 5/2006, of 10 May of the Fifth Book of the Civil Code of Catalonia), regarding *in rem* securities. The regulations in Catalonia entail numerous differences with the regulations of the Spanish Civil Code. The most notable one, in the case of share pledge of companies domiciled in Catalonia, is the general prohibition on granting more than one pledge over the same asset, unless the pledge is granted in favor of the same lenders and the security is distributed among the different facilities.

The consequence of this prohibition is that all lenders must participate in all the different facilities. If they do not, which is generally the case, there arises a problem when enforcing the pledge, as each lender can enforce the entirety of the pledge. In other words, each lender will have the right to execute the pledge for the full amount on a first come first serve basis.

EMEA leveraged finance partners

David Becker ●
Partner, London
T +44 20 7532 1405
E dbecker@whitecase.com

Paul Clews ●
Partner, London
T +44 20 7532 1436
E paul.clews@whitecase.com

Jill Concannon ●
Partner, London
T +44 20 7532 1534
E jconcannon@whitecase.com

Lee Cullinane ■
Partner, London
T +44 20 7532 1409
E lcullinane@whitecase.com

Chris Czarnocki ■
Partner, London
T +44 20 7532 1201
E cczarnocki@whitecase.com

Jeremy Duffy ■
Partner, London
T +44 20 7532 1237
E jduffy@whitecase.com

Gareth Eagles ■ ●
Partner, London
T +44 20 7532 1251
E geagles@whitecase.com

Jacqueline Evans ■
Partner, London
T +44 20 7532 1404
E jevans@whitecase.com

Martin Forbes ■
Partner, London
T +44 20 7532 1229
E martin.forbes@whitecase.com

Emma Foster ■
Partner, London
T +44 20 7532 1299
E efoster@whitecase.com

James Greene ■
Partner, London
T +44 20 7532 1439
E jgreene@whitecase.com

James Hardy ■
Partner, London
T +44 20 7532 2728
E james.hardy@whitecase.com

Colin Harley ■
Partner, London
T +44 20 7532 1200
E colin.harley@whitecase.com

Rob Mathews ●
Partner, London
T +44 20 7532 1429
E rmathews@whitecase.com

Jeffrey Rubinoff ■
Partner, London
T +44 20 7532 2514
E jeffrey.rubinoff@whitecase.com

Justin Wagstaff ●
Partner, London
T +44 20 7532 1222
E jwagstaff@whitecase.com

Ben Wilkinson ■
Partner, London
T +44 20 7532 1276
E ben.wilkinson@whitecase.com

Thierry Bosly
Partner, Brussels
T +32 2 2392 509
E tbosly @whitecase.com

Hadrien Servais ●
Local Partner, Brussels
T +32 2 2392 544
E hadrien.servais@whitecase.com

Claire Matheson Kirton ■
Partner, Dubai
T +971 4 381 6218
E CMathesonkirton@whitecase.com

Rebecca Emory ●
Partner, Frankfurt
T +49 69 29994 1432
E rebecca.emory@whitecase.com

Thomas Flatten
Partner, Frankfurt
T +49 69 29994 1233
E tflatten@whitecase.com

Tom Schorling
Partner, Frankfurt
T +49 69 29994 1525
E tom.schorling@whitecase.com

Florian Degenhardt
Partner, Hamburg
T +49 40 35005 298
E fdegenhardt@whitecase.com

Vanessa Schürmann ■
Partner, Frankfurt
T +49 69 29994 1431
E vanessa.schuermann@whitecase.com

Gernot Wagner ●
Partner, Frankfurt
T +49 69 29994 1430
E gernot.wagner@whitecase.com

Tanja Törnkvist
Partner, Helsinki
T +358 9 228 64 351
E ttornkvist@whitecase.com

Güniz Gökçe
Partner, Istanbul
T +90 212 355 1311
E guniz.gokce@gkcpartners.com

Yoko Takagi
Partner, Madrid
T +34 91 787 6320
E yoko.takagi@whitecase.com

Iacopo Canino
Partner, Milan
T +39 02 00688 340
E icanino@whitecase.com

Gianluca Fanti
Partner, Milan
T +39 02 00688 390
E gianluca.fanti@whitecase.com

Michael Immordino ●
Partner, Milan, London
T +39 020 068 8310
T +44 20 7532 1399
E mimmordino@whitecase.com

Alessandro Nolet ■
Partner, Milan, Hong Kong
T +39 020 068 8420
T +852 2822 0411
E alessandro.nolet@whitecase.com

Natalia Nikitina
Partner, Moscow
T +7 495 787 3027
E nnikitina@whitecase.com

Samir Berlat
Partner, Paris
T +33 1 5504 1551
E samir.berlat@whitecase.com

Colin Chang ●
Partner, Paris
T +33 1 5504 5815
E cchang@whitecase.com

Denise Diallo ●
Partner, Paris
T +33 1 5504 1518
E ddiallo@whitecase.com

Raphaël Richard
Partner, Paris
T +33 1 5504 1538
E rrichard@whitecase.com

Jan Linda
Partner, Prague
T +420 255 771 271
E jlinda@whitecase.com

David Plch
Partner, Prague
T +420 255 771 298
E dplch@whitecase.com

Jonathan Weinberg ■
Partner, Prague
T +420 255 771 262
E jweinberg@whitecase.com

Oscar Liljeson
Partner, Stockholm
T +46 8 50632 379
E oscar.liljeson@whitecase.com

Carl Hugo Parment
Partner, Stockholm
T +46 8 50632 341
E carlhugo.parment@whitecase.com

Magnus Wennerhorn
Partner, Stockholm
T +46 8 50632 370
E magnus.wennerhorn@whitecase.com

Nicholas Coddington ■
Local Partner, Warsaw
T +48 22 50 50 160
E ncoddington@whitecase.com

Tomasz Ostrowski ■
Partner, Warsaw
T +48 22 50 50 123
E tostrowski@whitecase.com

■ English Qualified ● US Qualified

White & Case LLP
Pº de la Castellana, 7
28046 Madrid
Spain

T +34 91 787 6300